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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

Nos. 278-282

RECONSTRUCTION FINANCE CORPORATION and others,

Petitioners,

vs.

THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY and others,

Respondents.

BRIEF OF THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY

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February 15, 1946.

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BRIEF OF THE DENVER AND RIO GRANDE WESTERN RAILROAD COMPANY*

Statement

This proceeding comes to this Court on writs of *certiorari* to review an Order or Decree of the United States Circuit Court of Appeals in the Tenth Circuit, dated May 10, 1945, which reversed two separate Orders of the District Court for the District of Colorado (Judge SYMES)—one an Order dated October 25, 1943, approving a Plan of Reorganization for the Respondent, The Denver and Rio Grande Western Railroad Company (herein called the Debtor) under Section 77 of the National Bankruptcy Act†

* The Respondent, The Denver and Salt Lake Western Railroad Company, a wholly owned subsidiary of The Denver and Rio Grande Western Railroad Company, concurs in and adopts this Brief.

† 11 U. S. C. § 205.

(herein referred to as Section 77); the other an Order dated November 29, 1944 confirming the same Plan of Reorganization after its rejection by the requisite percentage of the Debtor's General Mortgage Bonds (Tr., fol. 269).

The Debtor opposed the granting of the Petition for these writs of *certiorari* but believing that if this Court should determine to issue the writs it might desire a broad base for a reconsideration of its decisions rendered March 15, 1943, in the *Western Pacific* and the *Milwaukee* cases* the Debtor itself filed a separate Petition for a writ of *certiorari* which was designed to afford such a base should this Court desire it (No. 286, Oct. Term, 1945).

Questions Presented

The Question: What are the Questions Presented is one that may prove controversial. We feel that this question is not clarified by the Petition and Briefs of the Petitioners and that vital issues have been obscured.

As noted above there were two appeals from the District Court to the Circuit Court of Appeals. The appeals were argued separately and at different times—the appeal from the Order *approving* the Plan of Reorganization taken only by the Debtor was argued at Wichita, Kansas, on November 13, 1944; the appeal from the Order *confirming* the Plan taken by the Debtor and also by the Trustee of the General Mortgage and the Trustee of the Missouri Pacific Railroad Company was argued at Denver, Colorado, on March 14, 1945 (Tr., fols. 746; 784).

There can be no doubt at all under the language of sub-section (e) of Section 77 that the appeal from the last mentioned Order presented every question that was pre-

* *Ecker, et al. v. Western Pacific Railroad Corporation*, 318 U. S. 448; *Group of Institutional Investors, et al. v. Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 318 U. S. 523.

sented to the Court at Wichita plus a number of new and additional questions.

Sub-section (e) provides for the filing of Objections to a Plan of Reorganization certified to the District Court; a hearing upon such Objections and *after* such hearing if Objections have been filed but without a hearing if Objections have not been filed, an approval of the Plan if the Court finds that it meets all of the requirements specified in Clauses (1) to (3) of the first paragraph of said sub-section which include a finding that the Plan "is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders and will conform to the requirements of the law of the land regarding participation of the various classes of creditors and stockholders." If the Court finds that all of these requirements have been met an Order of Approval is granted as of course, subject to the general power reserved to the Bankruptcy Court as a court of equity and also implicit in sub-section (g) to do justice at any stage of the proceeding. But approval is not confirmation. *There must be further and very vital judicial action.* Sub-section (e) to this end provides that after the Plan has been approved by the Court it shall be submitted for acceptance or rejection by participating creditors and stockholders. If accepted and acceptances have not been made or procured by means forbidden by law an Order of Confirmation also issues as of course subject to the same general power reserved to the Bankruptcy Court, but if rejected the statute says "the judge may nevertheless confirm the plan if he is satisfied and finds after hearing—

(i) that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it;

(ii) that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and

(iii) that the Plan conforms to the requirements of Clauses (1) to (3) inclusive of the first paragraph of this sub-section (e)."

(The numbers (i), (ii) and (iii) are not in the text and are inserted for clarification and convenience in reference.)

So the Questions to be decided as limited by the *certiorari* as granted are:

First: Does the Plan of Reorganization as confirmed by the District Court make adequate provision for fair and equitable treatment for the interests and claims of the Debtor's General Mortgage Bonds?

Second: Was the rejection of the Plan by the General Mortgage Bondholders reasonably justified in the light of their respective rights and interests and all the relevant facts?

Third: Was the Plan one which the District Court was authorized to approve as meeting the requirements of Clauses (1), (2) and (3) of the first paragraph of sub-section (e)?

Incidental to these general questions are specific constitutional questions to which at the proper points the Court's attention will be directed.

Unless traditional rules of statutory construction are inapplicable in proceedings under Section 77 the required findings (i) and (ii) should be held to be in addition to and wholly distinct from the findings required by (iii) which is a reaffirmation of the findings required as the basis for the Court's Order of Approval. The apparent purpose of this requirement for a reaffirmation of the earlier findings is two-fold (a) to give the District Court a *locus poenitentiae* —a privilege of which Judge SYMES did not avail—and (b) to reinforce and implement the equity rule that "it is

the rights of the parties, at the time the decree is rendered, that ought to govern the Court in rendering the decree." (*Randel* v. *Brown*, 2 How. 406, 423.)

Status of the Debtor

In view of the attitude of the Petitioners in the Circuit Court of Appeals it may be helpful for counsel for the Debtor to state their conception of the Debtor's functions under Section 77. It is a mistake to assume—as hostile counsel are prone to do—that the Debtor appears solely or even primarily as the representative of equity interests. It is the Debtor's position that it is charged by Section 77 with a statutory duty to develop, to file and to carry through the Interstate Commerce Commission and the Courts a Plan of Reorganization which conforms to the law of the land and is fair and equitable to all classes of security holders and that in so doing it is the lawful representative of all security holders and creditors at least to the extent that they are not otherwise directly represented in the proceeding. This is the view of Judge Hincks who has devoted much of his judicial life to the affairs of the New Haven Railroad Company. At a pretrial conference Judge Hincks said:

> "The New Haven, Debtor, as it appears to me is acting in a fiduciary capacity primarily for junior equities although perhaps in a broader sense for all the composit securities."

That this must be the true view seems very evident when it is considered that Section 77 is so drawn as to permit the Debtor to file and to carry through a Plan of Reorganization without the intervention at any stage of the proceeding of a *single* party. The fiduciary capacity to which Judge Hincks here refers underlies Paragraph (4) of sub-section (c) which makes it mandatory for the offi-

cers of the Debtor to disclose any information bearing upon the fairness of any Plan and it should be noted also that Paragraph (13) of the same sub-section provides that the Debtor shall have the right to be heard on all questions arising in the proceeding—not questions relating to the equity position but *all* questions.

Scope of Debtor's Brief

In the argument which follows, counsel for the Debtor will first deal with the questions set out above relating to the inadequacy of the provision for fair and equitable treatment for the Debtor's General Mortgage Bondholders and their justification for rejecting the Plan and will then discuss very briefly what counsel conceive to be the unlawful and inequitable impacts of the Plan of Reorganization upon property rights of the Debtor as protected by the law of the land.

Appendix A is a critical analysis of certain recent reorganization decisions rendered by this Court. This was prepared for use of the Congress in connection with pending legislation. We think these decisions are wrong and in the Debtor's Petition in No. 286 we ask that they be reconsidered. Since this Petition is being held by the Court our views as amplified in Appendix A are submitted for such consideration as this Court may deem appropriate.

SUMMARY OF ARGUMENT

I

The Plan of Reorganization for the Debtor (a) does not make adequate provision for fair and equitable treatment for the interests and claims of the Debtor's General Mortgage Bondholders and (b) its rejection by them was reasonably justified in the light of their respective rights and interests and of all relevant facts.

The argument under this heading is presented in two subdivisions (a) and (b) which are preceded by a brief analysis of the protective provisions of Section 77 which Congress must have assumed to be a constitutional substitute for the traditional safeguards of a public sale. A question is here raised and discussed as to the value of these protective provisions under the interpretation placed upon Section 77 by the Interstate Commerce Commission and the Courts. This question is further discussed in an analysis of certain decisions of this Court which was prepared by one of the Petitioner's counsel for the use of the Congress in connection with pending legislation and is annexed as Appendix A.

A

The Plan of Reorganization does not make adequate provision for fair and equitable treatment for the interests or claims of the General Mortgage Bondholders

The basic argument under this subdivision is that provision for fair and equitable treatment is not afforded the General Mortgage Bondholders because it is possible to give far better treatment *within* the valuation and *within* the capitalization prescribed by the Interstate Commerce

Commission and *without* a revaluation reflecting subsequent economic changes and the Debtor's enhanced earning power. It is argued that by reason of this patent defect in the Plan the Order of Approval given by the District Court was properly reversed and the proceeding referred back to the Interstate Commerce Commission for a new Plan regardless of the rejection of the Plan by the Debtor's General Mortgage Bondholders—such reference back being mandatory under subsection (e) of Section 77.

B

The rejection of the Plan of Reorganization by the General Mortgage Bondholders was reasonably justified in the light of their respective rights and interests and all the relevant facts.

The argument under this subdivision is an interpretation of the provisions of subsection (e) of Section 77 relating to rejection set out in three separately numbered parts (*ante*, pp. 3-4) and an explanatory statement of the intent and purpose of these provisions made by the late Joseph B. Eastman when Coordinator of Transportation to the President of the United States and the Seventy-Fourth Congress—the substance being that the limitation on the otherwise unconditional veto power of 33⅓% of any participating class is aimed at obstructionists trying to secure unduly preferential treatment and should not be otherwise construed. (Report of Joseph B. Eastman, Coordinator of Transportation to the President and the Seventy-Fourth Congress—H. D. No. 89.)

In support of the argument that the General Mortgage Bondholders were reasonably justified in rejecting a Plan of Reorganization giving them 10% treatment when they felt justly entitled to 100% treatment there are four separate specifications as set out or paraphrased below.

(1) *The Plan was based upon an obsolete record.*

It is here shown that 90% of the claims of the General Mortgage Bondholders were held worthless on the basis of a record which for practical purposes had been closed for many years and was formally closed May 20, 1941, and that a motion to reopen made May 1, 1943 to receive evidence of changed economic conditions had been denied contrary to the following authorities:

Ecker v. *Western Pacific Railroad Corporation*, 318 U. S. 448;

Group of Institutional Investors v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 318 U. S. 523;

National Labor Relations Board v. *Phelps*, 136 F. 2d, 562;

Atchison, Topeka & Santa Fe Railway Company v. *United States*, 284 U. S. 248.

The following cases alleged to overrule *Atchison, Topeka & Santa Fe Railway Company* v. *United States* are distinguished:

United States, et al. v. *Northern Pacific Railway Company*, 288 U. S. 490 (1933);

St. Joseph Stock Yards Company v. *United States*, 298 U. S. 38 (1938);

Baltimore & Ohio Railroad Company v. *United States*, 298 U. S. 349 (1936);

Interstate Commerce Commission v. *Jersey City*, 64 S. Ct. Rep. 1129 (1944).

(2) *The Plan offered less than the impounded income applicable to the General Mortgage Bondholders.*

It is here shown that for a claim including contract interest amounting to $43,548,155 on which interest *pendente lite* in excess of all accruals on senior debt at contract rates

amounts to $9,389,418 the General Mortgage Bondholders are offered $4,353,816 in common stock—less than half of the impounded income.

(3) *A reasonable doubt had arisen as to the prior interpretation of Section 77.*

Here it is argued that the General Mortgage Bondholders were justified in rejecting a Plan giving them 10% treatment in common stock under an interpretation of Section 77 which the Judiciary Committee of the House of Representatives had said in its Report to the House of Representatives in recommending the passage of H. R. 4960—afterwards H. R. 31—was wrong and was resulting in "unbearable hardship" to various holders of railroad securities including "Denver & Rio Grande Western."

(4) *The Plan of Reorganization disregards the law of the land in its treatment of the capital stock of the Utah Fuel Company.*

Under this specification it is shown that the stock of the Utah Fuel Company in the par amount of $10,000,000 pledged under an underlying mortgage subject to withdrawal by junior lienors and preferred stockholders at $6,000,000 and *restrictively* pledged was given as a bonus to the underlying lienor without valuation and in violation of the conditions of the pledge. This is dealt with subsequently as a breach of trust constituting an independent ground for reversal of the Approval Order made by the District Court.

In concluding the argument under this section of the Brief it is urged that most of the infirmities in the Plan which are featured in the Opinions of Judges HUXMAN and PHILLIPS are common to the 16 pending cases set out in a foot-note, all of which are deemed discredited by the dissenting Opinion of the late Joseph B. Eastment in St. Louis Southwestern Reorganization, 249 I. C. C. 5 (p. 191).

II

The Plan of Reorganization attempts to destroy the property rights of the Debtor and its stockholders contrary to the intent and purpose of Section 77 of the National Bankruptcy Act, to rudimentary principles of natural justice, and to the law of the land.

In limine under this heading it is pointed out that by mandate of subsection (e) the proceeding must be referred back to the Interstate Commerce Commission to proceed anew under subsection (d) and it is noted that in recognition of this mandate the Opinion of the Circuit Court of Appeals expressly provides:

> "Nothing in this opinion shall prejudice or foreclose the rights of the parties to propose a new plan of reorganization or the power of the Commission to formulate, approve, and certify a new plan of reorganization in the light of any relevant facts presented to the Commission in any proceeding under 11 U. S. C. Sec. 205(d). It is so ordered."

It is argued that both the statute and the most rudimentary principles of natural justice entitle both the General Mortgage Bondholders and the Debtor to present and support a new Plan that will reflect recent radical changes in the National economy and the improved earning power of the Debtor's properties.

Reasons are here assigned showing why the Commission's valuation was arbitrary and the *fiat* of a non-judicial body and why any Plan based upon a valuation that would not give 100% treatment to the General Mortgage Bonds and a substantial participation for stockholders would be confiscatory. The latter include—

(a) radical lowering of long time money rates;

(b) permanent elevation of National income through intensified industrial activity;

(c) construction of mammoth steel plant at Geneva, near Provo, Utah;

(d) increased earning power incident to $43,000,000 of capital expenditures *pendente lite*;

(e) numerous other factors specified in the Opinion of Circuit Judge PHILLIPS;

(f) fixation of rights by principles of bankruptcy and subsection (1) of Section 77.

In support of (f) the following authorties are cited:

Sexton v. *Dreyfus*, 219 U. S. 348;

People v. *American Loan & Trust Company*, 172 N. Y. 371;

Merrill v. *National Bank of Jacksonville*, 173 U. S. 131;

Board of Commissioners of Shawnee County, Kansas v. *Hutley*, 169 Fed. Rep. 92.

In concluding this division of the argument it is urged that a fair revaluation of the Debtor's properties would require an over-all figure in excess of $205,000,000 and an illustrative Plan of Reorganization is outlined which without increasing the Commission's basic valuation beyond the additional capital reinvested in the property by the Court will make all creditors whole and provide a substantial equity for the Debtor's capital stock. This Plan contemplates either a judicial revaluation or a public sale of the capital stock of the Utah Fuel Company and an application of the proceeds of sale in accordance with the terms of the pledge. A sale divorcing the production of coal from its transportation is advocated in view of the Commodities Clause of the Interstate Commerce Act—49 U. S. C. A. Ch. 1. Sec. 1(8).

Conclusion

The Debtor asks that the reference of the proceeding back to the Interstate Commerce Commission under subsection (e) be approved and that the Plan as made and the principles underlying its making be accorded a plenary resurvey.

ARGUMENT

I

The Plan of Reorganization for the Debtor (a) does not make adequate provision for fair and equitable treatment for the interests and claims of the Debtor's General Mortgage Bondholders and (b) its rejection by them was reasonably justified in the light of their respective rights and interests and of all relevant facts.

Prior to the enactment in 1933 of Section 77 of the National Bankruptcy Act the lien creditor of a Railroad Company could not be divested of his lien nor a debtor of his property through a reorganization without the protection of a public sale which ordinarily included a judicially pre-determined minimum price.

Section 77 of the National Bankruptcy Act offered as an alternative a reorganization safeguarded *inter alia* by the following protective requirements:

First: The opinion of an independent administrative body—the Interstate Commerce Commission—that the Plan of Reorganization is fair and equitable and otherwise meets meticulous specifications for the protection of property rights.

Second: A judicial approval which cannot lawfully be given unless and until the Court is "satisfied" that every one of those meticulous specifications has been met.

Third: Acceptance by two-thirds of each class of creditors voting thereon, but subject to a limited exception aimed at extortion and designed to prevent, *not to confirm*, injustice.

Fourth: Confirmation *only* after such creditor acceptance and a terminal activation of the conscience of the Court.

It is our contention urged with the utmost deference that the first and second of these three safeguards are of little if any value under the interpretation placed upon Section 77 by the Interstate Commerce Commission and afterwards accepted by this Court; and in this contention we are fortified by a Report made retrospectively by the Judiciary Committee of the House of Representatives which framed the Section (Tr., fol. 262).

Our views on the questions of interpretation are elaborated in Appendix A.

Except as we refer to and rely upon Appendix A and the basic requirements of due process the discussion under this Point will be limited to an effort to preserve in its full integrity the third safeguard: the right of the security holders to protect themselves by rejection of a Plan. As was observed in our Brief opposing the issue of the writ of *certiorari*, the third safeguard, the very last trench in the security-holders' line of defense against confiscation of their property is under heavy assault by Reconstruction Finance Corporation, the Insurance Companies and a chain of some 1,000 or more Savings Banks throughout the United States all working together in these Section 77 proceedings. One of the enigmas of the times (and there are many such) is the willingness of these great fiduciary institutions to cooperate with and aid the Interstate Commerce Commission in breaking down the statutory and constitutional safeguards against the expropriation of private property.

(A) The Plan of Reorganization does not make adequate provision for fair and equitable treatment for the interests or claims of the General Mortgage Bondholders.

The Plan of Reorganization offers to the General Mortgage Bondholders 10% of their claim in common stock representing 10% of the total issue. To quote Circuit Judge PHILLIPS this is "harsh treatment." The most callous confiscationist would admit that this is "harsh treatment" and is inadequate provision for fair and equitable treatment if better treatment can be given without taking anything given under the Plan to those in a superior position. There is no serious claim that far better treatment is not practicable *within* the valuation and *within* the capitalization prescribed by the Interstate Commerce Commission and *without* a revaluation reflecting the changes in economic conditions and the Debtor's enhanced earning power. From a number of different sources it is possible vastly to improve the position of General Mortgage Bonds without a revaluation. These sources include the securities released by the retirement of First Mortgage Bonds of The Rio Junction Railway Company, the securities released by the retirement of Equipment Trust Obligations and uncapitalized cash in excess of the working capital contemplated by the Plan. The facts as to these possible provisions for better treatment for junior debt are not in dispute and their existence puts the case outside of the sole exception to the unqualified right of veto given to one-third of the voters in any class to which a Plan is submitted. The Approval Order of the District Court having been reversed the proceeding was referred back to the Interstate Commerce Commission by the Circuit Court of Appeals under mandate of sub-section (e) of Section 77 to proceed anew without the necessity of a decision—which it nevertheless made and now to be discussed—that the rejection of the Plan of Reorganization by the General Mortgage Bondholders met the statutory test of reasonableness.

(B) The rejection of the Plan of Reorganization by the General Mortgage Bondholders was reasonably justified in the light of their respective rights and interests and all the relevant facts.

The Petitioners argue that rejection of a fair and equitable Plan of Reorganization can never be reasonably justified; that if the Plan is fair and equitable it cannot be altered to improve the position of a rejecting class without taking something from another class and thereby throwing the equities out of balance. If this be true the statutory provision set out *ante* pages 3-4 for rejection which we have numbered (ii) is a meaningless one because it is overlapped by the provisions which we have numbered (i) and (iii). Their argument is faulty both legally and factually; it is bad legally because it violates the cardinal rule that effect must be given to every clause of a statute; it is wrong factually because under the preceding head-note we have cited a number of factors which come into play in this very case to make possible substantially better treatment for the General Mortgage Bondholders than is given by the Plan without taking anything from anybody and without throwing any equity out of balance.

There may, however, be a multitude of relevant facts which reasonably justify rejection of a Plan of Reorganization which has been found to be fair and equitable by the Commission and the Court. Adequate provision for fair and equitable treatment is a *sine qua non* of a valid Plan before it even may be submitted for acceptance or rejection by parties in interest. So the statute necessarily contemplates an area of disagreement in which the veto of such a Plan by a vote in excess of 33⅓% of any class is absolute. Sub-section (e) delimits this area and we think that it does so aptly and effectively. But the late Joseph B. Eastman, who as Coordinator of Transportation sponsored the amendatory Section 77, explained this clause lucidly in a communication to the President and the Seventy-Fourth

Congress printed as H. D. No. 89, from which we briefly quote:

> "Arbitrary compulsion of plans over the dissents of the interested classes is not intended, nor is it believed that the courts will override strong dissents by any large number of such classes, or by a single large class, excepting where it is established that they have no interest in the property. Rather, the purpose is to prevent the obstruction of plans which are favored by the larger classes of creditors or shareholders, but which are obstructed by minorities in the smaller classes in the attempt to secure unduly preferential treatment."

The General Mortgage Bondholders are not obstructionists trying to secure unduly preferential treatment.

They are acting advisedly within the prescribed area of permissible disagreement to say that they do not accept the Plan which gives them 10% treatment when they should be given 100% treatment. They say this for a number of valid reasons, any one of which reasonably justifies their rejection of what the Interstate Commerce Commission has offered them.

We shall refer briefly to those which impress us as worthy of emphasis. There are many others that will suggest themselves to this Court after reading the mutually supplementary Opinions of Judges HUXMAN and PHILLIPS.

(1) The Plan was based upon an obsolete record.

The record in the Interstate Commerce Commission was closed on May 20, 1941. On May 1, 1943, the Debtor filed a Petition for leave to offer proof of changed economic conditions and operating results and of assets realized subsequent to May 20, 1941. The Petition alleged:

> "The Debtor, if afforded an opportunity to do so by this Commission, is prepared to show by evidence

> which it believes will prove to be of the most convincing character that since the close of the hearings in this Commission a greatly increased earning power has been developed much of which is in no way connected with the War or the War economy and is so far of a permanent and durable nature that it could not properly be ignored in an appraisal of the Debtor's properties and earning power for the purpose of said Section 77" (Tr., fol. 734).

This Petition was filed in the light of what was said in the Opinions of this Court in the *Western Pacific* and *Milwaukee* cases as to the setting aside of a Plan which is shown by evidence to have become unfair and inequitable by reason of changed conditions. These Opinions show a very clear recognition by this Court of the right of an injured party to require that a Plan be set aside in such circumstances. In neither of those cases, however, had there been an application to the Interstate Commerce Commission of the character set out above and what was said in those cases related only to such changes in economic conditions and the consequences thereof as at that early period of the changing cycle were within the necessarily narrow and restricted judicial knowledge of this Court.

The Court's vision was then obscured by the fog of a depression which was rising but had not yet lifted.

The Interstate Commerce Commission ignored the Debtor's Petition up to the time of the release of its Third Supplemental Report dated June 14, 1943, in which appears the following uninformative reference:

> "We have denied the Debtor's request for a further hearing filed on May 1, 1943."

At the same time the Commission made an Order also dated June 14, 1943 formally denying the Debtor's Petition on the unrevealing ground—

> "that additional evidence of the nature referred to in the Debtor's Petition filed on May 1, 1943, is not

required for a determination of the matter involved in a further modification of the aforesaid Plan of July 18, 1942" (Tr., fol. 739).

In the Debtor's Objections to the Plan of Reorganization as certified to the District Court by the Interstate Commerce Commission in its Third Supplemental Report the Debtor states:

> "*In limine* the Debtor objects to any consideration by the District Court of the Plan of Reorganization certified as aforesaid to the Court by the Interstate Commerce Commission on the ground that the Commission's determination was made without a hearing of the character required by the Fifth Amendment to the Constitution of the United States and is in effect an attempt to take the Debtor's property without due process of law and without observing due process as provided by Section 77 of the National Bankruptcy Act.
>
> "Specifically the Debtor excepts to and objects to a denial of the Debtor's petition filed with the Commission on May 1, 1943, a copy of which is hereto annexed and made a part hereof; and the Debtor hereby moves for an order by this Court referring this proceeding back to the Interstate Commerce Commission to receive evidence of the character outlined therein and for proceedings in accordance with the Statutes of the United States" (Tr., fol. 742).

The Debtor contends and respectfully asks this Court to hold that the Commission's denial of the Debtor's Petition filed May 1, 1943 if not a denial of due process was an abuse of discretion which alone required judicial disapproval of the Plan.

In Circuit Judge HUTCHESON's note to his Opinion in *National Labor Relations Board* v. *Phelps*, 136 F. 2d, 562, the learned Judge uses the following striking language:

> "Regulatory Commissions have been invested with broad powers within the sphere of duty assigned

> to them by law. Even in quasi-judicial proceedings their informed and expert judgment exacts and receives a proper deference from courts when it has been reached with due submission to constitutional restraints. Indeed, much that they do within the realm of administrative discretion is exempt from *supervision* if those restraints have been obeyed. All the more insistent is the need, when power has been bestowed so freely that the 'inexorable safeguard' of a fair and open hearing be maintained in its integrity. The right to such a hearing is one of 'the rudiments of fair play' assured to every litigant as a minimal requirement. There can be no compromise on the footing of convenience or expediency or because of a natural desire to be rid of harassing delay, when that minimal requirement has been neglected or ignored."

Reference must here be made to the following language of retired Chief Justice HUGHES in *Atchison, Topeka & Santa Fe Railway Company, et al.* v. *United States, et al.*, 284 U. S. 248:

> "In the instant proceeding, the hearing accorded related to conditions which had been radically changed, and a hearing, suitably requested, which would have permitted the presentation of evidence relating to existing conditions, was denied. We think that this action was not within the permitted range of the Commission's discretion, but was a denial of right. The order of the Commission which was thus made effective, and the ensuing supplemental order, cannot be sustained."

The case last cited (herein called the *Atchison* case) is a parallel one which cannot possibly be distinguished.

There has been no effort to distinguish it but it is said to have been overruled by the cases cited below.* Without

* *United States, et al.* v. *Northern Pacific Railway Company*, 288 U. S. 490 (1933); *St. Joseph Stock Yards Company* v. *United States*, 298 U. S. 38 (1938); *Baltimore & Ohio Railroad Company* v. *United States*, 298 U. S. 349 (1936); *Interstate Commerce Commission* v. *Jersey City*, 64 S. Ct. Rep. 1129 (1944).

undertaking to deal separately with each of these cases we ask this Court to note the following features:

(a) All of the cases, even the *Atchison* case, were *rate* cases where there is no finality and a new complaint may be filed at any time based upon changed conditions.

(b) In all of these cases, except the *Atchison* case, the petition was for a technical reargument to set aside an order already made and was not an application to permit the introduction of supplementary evidence in a pending proceeding in order to bring up to date a record that was stale and notoriously obsolete.

(c) In none of the later cases is it questioned that the *Atchison* case is a binding authority in any subsequent case where the basic facts are identical and the abuse of discretion is manifest.

(d) In the last of the cases the Court was dealing primarily with the normal lag or gap between the closing of the record and the time the administrative decision is promulgated. It is quite appropriate in such a case that the question of reopening the record in order to bridge the inevitable normal lapse of time should be left to the discretion of the administrative body.

But that is not our case.

Here the record had been closed for a period of approximately two years in which had occurred a world-wide economic upheaval without precedent in history and in which earning power of industry in general and of our transportation systems in particular had risen to undreamed of levels, much of the increased earning power being the result of factors that may readily be shown to be of a permanent nature. No true estimate of the Debtor's earning power could possibly be made without exploring all of these new factors at an open, unrestricted hearing in the Interstate Commerce Commission and without giving ef-

fect to evidence which such a hearing may develop.† If an irremediable forfeiture, such as is abhorred by equity, of property rights running into many millions of dollars might be averted by a further hearing such a hearing becomes mandatory under the letter and spirit of *Atchison, Topeka & Santa Fe Railway Company, et al.* v. *United States* which we think applies in its full vigor unaffected or unimpaired by anything said in the subsequent opinions. We do not think *Atchison, Topeka & Santa Fe Railway Company* v. *United States* has been overruled—indeed "the rudiments of fair play" (to re-quote Judge HUTCHESON) which underlie that decision may well be beyond the reach of judicial abrogation. But regardless of whether the arbitrary action of the Commission constitutes "a denial of right" (again to quote former Chief Justice HUGHES) it certainly "reasonably justified" the General Morfgage Bondholders in rejecting a Plan of Reorganization which deprived them of all but 1% of their investment knowing as they must of known that a fair reappraisal on the basis of newly developed but heretofore undemonstrated earning power would have made them whole and placed below them a valuable supporting equity.

(2) **The Plan offered less than the impounded income applicable to the General Mortgage Bondholders.**

If one should recklessly drive to death a post horse hired for a journey to Market Harborough and should offer the owner in settlement for the entire loss a sum actually 50% less than the amount stipulated to be paid as hire for the horse and not one farthing for the horse, that offer would parallel this case. Incredible as it may seem, the General Mortgage Bondholders are offered for their claims amounting with contract interest as of January 1, 1943, to $43,548,'55 common stock in the par amount of $4,354,816 whereas on August 1, 1944, which is the nearest date to the hearing on

† Certain of these factors are developed in a section of the Opinion of Circuit Judge PHILLIPS quoted herein—*post*, page 34.

Confirmation the accumulated income earned *pendente lite* in excess of all contract interest on prior lien debt amounted to $9,389,418, more than double the amount offered in common stock for the whole claim. While the impounded income may not be available to the General Mortgage Bondholders in cash because properly applied in reduction of principal of senior lien debt or prudently reinvested in the property such reduction of the prior lien debt or prudent reinvestment necessarily increases by that precise amount the securities available in reorganization for junior debt. It is difficult to understand how an offer of $4,353,816 in common stock on a lien claim of $43,548,155 on which income earned *pendente lite* in excess of interest accruals on prior debt amounts to $9,389,418* is an honest Plan much less a fair and equitable Plan; it is impossible to understand how it could be judicially determined that a rejection of such a Plan by the lien creditors thus victimized was not "reasonably justified."

(3) **A reasonable doubt had arisen as to the prior interpretation of Section 77.**

The Plan of Reorganization under which holders of General Mortgage Bonds were to be accorded 10% treatment in common stock representing only 10% of the proposed issue was pending for their acceptance or rejection under sub-section (c) of Section 77 when the Judiciary Committee of the House of Representatives released its unanimous Report (No. 1615) recommending passage of H. R. 4960 in which the Judiciary Committee said in the opening paragraph:

> "The purpose of the bill is to correct a very serious situation arising from the interpretation placed by the Interstate Commerce Commission and the Courts upon amendments of Section 77 enacted by Congress August 27, 1935. We believe this situation results from a misapprehension of the intention of Congress with respect to the 1935 amendments. The consequences have been and are so disastrous to rail-

* The amount shown in City Bank Farmers Trust Company Ex. 10 at folio 382 of the Transcript—$9,779,021—is partially estimated. The final figure is as stated above.

road investors and so dangerous to the credit of the railroads in general that they should be corrected by legislation" (Tr., fol. 262).

This is followed by examples which this situation created of "unbearable hardship" upon junior investors in railroad securities. Among those specifically mentioned is "the Denver & Rio Grande Western." It was therefore not surprising that four out of every five holders of General Mortgage Bonds rejected the Plan. It is an understatement to say that they were "reasonably justified." Rejection was an obvious duty from which no well informed General Mortgage Bondholder could escape.

4. The Plan of Reorganization disregards the law of the land in its treatment of the capital stock of the Utah Fuel Company.

Many questions of grave import arise out of the dispositive provisions of the Plan of Reorganization respecting the capital stock of the Utah Fuel Company. Here again appear relevant facts which taken alone constitute adequate justification for rejection of the Plan by General Mortgage Bondholders. By methods of doubtful constitutionality plainly violative of valid contract reservations the General Mortgage Bondholders are to be divested of a valuable equity in this *restrictively* pledged stock which is given away by the Interstate Commerce Commission either without valuation or at an undisclosed valuation as a bonus or sweetening gratuity to a group of prior lien creditors who appear already to have been made whole under their Plan. This factor also constitutes an independent legal ground for judicial disapproval of the Plan without regard to its subsequent rejection by the General Mortgage Bondholders and in this aspect will be discussed at a subsequent point. References to the stock of the Utah Fuel Company in the Reports of the Interstate Commerce Commission and to the basic documents are set out below.*

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* Submission Pamphlet—pp. 38, 52, 53, 70, 77, 78, 123, 135, 136. Tr. fols. 1541-1557; Exhibits 34, 34J, 35, 36, 37A; fols. 1496, 1498, 1525.

The Utah Fuel Company owns and operates coal mines in the region of Provost near Salt Lake City, Utah; its coal reserves underlying the Wasatch Range of the Rocky Mountains have been scarcely scratched in its successful operations extending over a period of nearly 50 years. By reason among others of the quality and accessibility of this vast reserve of coal the United States Government has constructed near Geneva in the environs of Provo and at the very portals of these mines, the largest and most modern steel plant now in existence at a cost exceeding $200,000,000 which is far greater than what appears to be the Commission's notion of the value of the entire Denver and Rio Grande Railway System.

This plant was constructed after the formulation of the Plan of Reorganization which the General Mortgage Bondholders have rejected and the Circuit Court of Appeals has set aside.

In the depression year of 1935 the Utah Fuel Company had earned $83,000 when many of the strong units of the coal industry throughout the United States were running large deficits and a number were in receivership or reorganization (Poor's 1937 Industrial Volume, pp. 1635-1636; 1802, 2208). In 1943 after the depression had receded and the Geneva steel plant had been put into production the earnings had reached the approximate level of $1,000,000 representing more than a ten-fold increase over 1935. (Tr., fols. 1102; 1460).

The capital stock—$10,000,000 par value, all common shares—had been pledged as part security for First Consolidated Mortgage Bonds of the Rio Grande Western Railway Company (one of the Debtor's early constituents) in the amount of $15,080,000. The pledge of the stock under this underlying mortgage was made by a supplemental indenture executed by Messrs. Spencer Trask and Company, New York bankers, a number of years after the execution of the original mortgage. The pledge was subject to an

expressly reserved right of release and withdrawal of the stock upon deposit with the mortgage trustee of $6,000,000 which happened to coincide with the principal amount of First Consolidated Mortgage Bonds simultaneously issued to the bankers. The rights of withdrawal and redemption and ultimate equity of and in the stock were afterwards transferred by legal proceedings not here material to the present owners of the common capital stock of the Debtor, The Denver and Rio Grande Western Railroad Company. This subsequent transfer was subject in all respects to the liens in the order of their respective priorities of the two junior mortgages securing Bonds of the Debtor to which participation is accorded by the terms of the Commission's Plan of Reorganization—these being the Refunding and Improvement Mortgage and the General Mortgage. The present rights of the various parties in interest are set forth in certain agreements referred to in the last foot-note, one of which provides (reversing the rule applicable to accommodation collateral) that the Utah Fuel Company stock must be liquidated and applied to the payment of the First Consolidated Bonds before there can be a resort to other mortgage security.

In the formula which the Interstate Commerce Commission says it used in its formulation of the Plan of Reorganization an income of $83,000—the amount accruing in the depression year 1935—was credited to the First Consolidated Mortgage as one of the factors in its determination of the amount and character of securities to be allotted to holders of First Consolidated Mortgage Bonds. In addition, however, all of the stock of the Utah Fuel Company or the proceeds of sale (if the mortgage trustee elects to sell) are given outright to the holders of First Consolidated Mortgage Bonds and all rights of junior lienors, one of which is the Debtor's General Mortgage, are disregarded. It ought to be clear that this is fundamentally wrong. The very least that could be done correctively would be to credit the fair value—not the depression value—of the Utah Fuel

Company in reduction of the claim of the First Consolidated Mortgage Bondholders. The effect of such credit would be to pass the amount thereof down to the highest ranking junior lienor not already made whole and this would be the General Mortgage which is given $4,354,816 in common stock for a claim asserted in the amount of $43,548,155.

This brings up the more critical constitutional question—how is the fair value of the Utah Fuel Company to be determined in accordance with the law of the land. Discussion of this question will be reserved for a subsequent point. It is sufficient here as justifying the adverse vote of the General Mortgage Bondholders to note with appropriate emphasis that a capitalization of earnings at the 1943 level—presumptively the permanent level—using the unjustifiably high rate of 5% would indicate a value of approximately $20,000,000, all of which should be carried down to the General Mortgage Bondholders.

To multiply further the relevant facts which reasonably justify the rejection of the Plan of Reorganization promulgated for the Debtor would unduly extend this Brief. Sufficient has been shown to condemn the Plan utterly and completely. It should be emphasized, however, that the Plan for the Debtor is fairly typical of those for sixteen pending cases to which the Interstate Commerce Commission is in principle committed. As early as June 30, 1941, the late Joseph B. Eastman, then Chairman of the Interstate Commerce Commission and soon to be made Director of the Office of Defense Transportation, had reached the conclusion that much of the increased carrier revenue was of a permanent nature and that Plans of Reorganization on the Commission's pattern could no longer be justified.* In no subsequent case, so far as we have been able to determine, did Commissioner Eastman approve of or concur in any Commission Plan which con-

* St. Louis Southwestern Railway Company Reorganization, 249 I. C. C. 5, at 191.

fiscated the equity on the basis of pre-war depression earnings. In the sixteen cases now pending the aggregate of the securities representing the equity of the stock is $1,162,062,000.† Most of the infirmities in the Plan of Reorganization of the Debtor which are featured in the Opinions of Judges HUXMAN and PHILLIPS are in some form or other common to the pending Section 77 cases, all of which should be referred back to the Interstate Commerce Commission for reconsideration. A list of these cases is shown below.*

II

The Plan of Reorganization attempts to destroy the property rights of the Debtor and its stockholders contrary to the intent and purpose of Section 77 of the National Bankruptcy Act, to rudimentary principles of natural justice, and to the law of the land.

Under the previous point we have attempted to show (we think successfully) that the Plan of Reorganization does not make adequate provision for fair and equitable treatment for the interests and claims of the Debtor's Gen-

† Since this calculation was made the Plan of Reorganization for the Chicago, Milwaukee, St. Paul and Pacific Railroad Company has been consummated by delivery of the new securities and the elimination of the equity of its stockholders appears to be a *fait accompli*. This is not therefore treated herein as a pending proceeding although an appeal has been taken from an Order denying a motion for a modification of the Decree pursuant to which the new securities have been issued.

* Alton
Central of Georgia
Central Railroad of New Jersey
Chicago, Indianapolis & Louisville
Chicago, Milwaukee, St. Paul and Pacific Railroad Company
Chicago, Rock Island & Pacific
Denver & Rio Grande Western
Duluth, South Shore & Atlantic
Florida East Coast
Missouri Pacific Lines
New York, New Haven & Hartford
New York, Ontario & Western
New York, Susquehanna & Western
Rutland
St. Louis-San Francisco
St. Louis Southwestern Lines

eral Mortgage Bondholders. If this has been demonstrated it then follows under the clear mandate of subsection (e) that the proceeding must be referred back to the Interstate Commerce Commission for a new Plan which goes forward in accordance with subsection (d). It is in recognition of this statutory mandate that the Opinion of the Circuit Court of Appeals expressly provides—

> "Nothing in this opinion shall prejudice or foreclose the rights of the parties to propose a new plan of reorganization or the power of the Commission to formulate, approve, and certify a new plan of reorganization in the light of any relevant facts presented to the Commission in any proceeding under 11 U. S. C. Sec. 205(d). It is so ordered" (Tr., fols. 261-262).

One of the obvious rights of the General Mortgage Bondholders upon such a reference back is the right to file a new Plan of Reorganization for the Debtor and to endeavor to support it by evidence which—

> (a) will reflect the true present day value of the Debtor's properties;
>
> (b) will make the General Mortgage Bondholders whole; and
>
> (c) will provide for the largest possible junior equity to support and give the maximum permissible margin of safety for the new securities to be issued to the General Mortgage Bondholders under the new Plan.

The same right in the Debtor to file and support by evidence of present day values a Plan that will give due recognition to the Debtor and its stockholders is implicit in the same two subsections of Section 77.

There is nothing in either subsection (d) or subsection (e) to indicate a Congressional intent that the Debtor may be put out of the proceeding *pendente lite* and permanently

deprived of property rights for which a value might be established by economic changes and by huge accumulations of cash and impounded income developed during the further progress of the proceeding to final decree.†

Equity which abhors a forfeiture could not well forfeit property rights on the basis of an interlocutory judgment.

Even if the permanent elimination of the Debtor at a preliminary stage of the proceeding had been contemplated by Congress (which we submit was not the case) it would offend rudimentary principles of natural justice, shock the conscience, and violate the law of the land to exclude the Debtor in the present proceeding from further participation by reason of a death sentence imposed in a period of hysteria upon a record which was unsound in its inception and has become obsolete as the result of a new economy.

A brief summary of the Debtor's complaints ought to be sufficient to end the argument.

The reproduction cost less accrued depreciation of the Debtor's road and equipment arrived at by methods approved by this Court were shown to be not less than $205,000,000 at the hearing in the District Court held July 29, 1940 (Tr., fols. 1259-1260). This valuation of physical elements does not reflect—

(a) common stock of the Utah Fuel Company $10,000,000-$20,000,000 (Tr., fols. 1261; 1460);

(b) development cost at 5%—$10,000,000 (Tr., fols. 1257-1260);

† In an opinion of the Securities Exchange Commission released January 25, 1946, in the matter of the reorganization of the Commonwealth and Southern Corporation it is stated:

"Market valuations are higher than when the plan approved by the SEC was filed. It would be unfortunate to cut off finally any appreciation which common stockholders might realize as a result of improved future earnings, prospects and market conditions.

"Careful consideration should be given to the possibility that a change in the form of reorganization might preserve larger interest for common stockholders, while fully satisfying the claims of preferred stockholders."

(c) nor present day prices at least 20% above those of 1940—$41,000,000.*

These are but a few of many elements of *added* value to which due process requires that a court of equity give heed.

The Debtor's investment in road and equipment at the same date was greatly in excess of $205,000,000 (Annual Report, 1935, p. 12).

This understates by many millions of dollars the present value of the property of the Debtor devoted to public service upon which it is guaranteed the right to earn a fair return by the Fifth Amendment.

A fair revaluation of the Debtor's property on the basis of the present day prices and altered economic conditions to which we think the General Mortgage Bondholders as well as the Debtor are indubitably entitled would support a new capitalization well above $205,000,000 unless the value of the physical elements may lawfully be written down in a proceeding under Section 77 by a capitalization of the undisclosed guess of an administrative Board as to the Debtor's earning power. It is the view of Debtor's counsel that the value of the Debtor's property devoted to public service cannot be written down for reorganization purposes under Section 77 as is here proposed. The protection of a public sale at which interested parties may become bidders should not be lightly put aside; but if it is to be put aside—and, rightly or wrongly (we think wrongly), this seems to be the trend in proceedings under Section 77—the evidence in justification of radical reductions proposed for the purpose of excluding the Debtor should be clear and convincing and when translated into the finding of an administrative Board should be fully and fairly disclosed so as to be susceptible of evaluation by and an adequate review in the Courts.

* In a Petition dated October 5, 1944 filed by the Rail Carriers in the Interstate Commerce Commission in *Ex Parte* 148 it is stated: "Since 1940 railway labor and costs have increased approximately 27% and the price of materials and supplies required by the Railroads have advanced an average of 29%."

The valuations alleged to have been made by the Interstate Commerce Commission in the pending proceeding fail to meet such a test.

If, as is claimed, these valuations are based upon a capitalization of future earnings the Debtor is left in ignorance of the two basic factors—first, it is left in ignorance as to the amount of the estimated annual income which the Commission has capitalized; and second, it is left in ignorance as to the interest rate which was used by the Commission as the basis of the computation. Since these factors are not disclosed the Debtor's properties are being taken away arbitrarily by *fiat* of an administrative Board and for that reason alone the Debtor is entitled to have the proceeding set aside and its properties revalued. Such right of revaluation exists by reason of the methods pursued by the Interstate Commerce Commission and is distinct from and independent of the right of the Debtor to a revaluation as incident to the subsequent economic changes which have rendered obsolete and unjust the Commission's earlier valuations even if they were fair when made which we respectfully submit they were not.

This brings into the foreground an impressive reason why *all* of the fifteen cases pending under Section 77 should be remanded to the Interstate Commerce Commission for reconsideration: in all of them the Commission's Plans have become unfair and inequitable by reason of recent economic changes which are revolutionary.

One of these changes is the radical lowering for the indefinite future of money rates.

The Plans in the fifteen cases pending (with only minor exceptions) assume 4% to be the minimum interest rate for new interest bearing securities to be issued in reorganization. In most cases a higher rate is provided for at least a part, if not all, of the new debt. The minimum assumed rate of 4% is now down to 3% as an incident of the change in the National economy. The trend is shown by the sub-

joined foot-note.* The New York Times (February 5, 1946) reports a sale by the Southern Pacific Railroad Company of $50,000,000 of First Mortgage 2⅞% Bonds at 100.6599 to replace Bonds issued less than six months ago bearing interest at 3¾%. The New York Times (February 7, 1946) reports a sale by Union Pacific Railroad Company of $44,193,000 of Thirty-Year 2⅞% Debenture Bonds having no lien at all at 108.50. Economists will testify (if they are permitted to do so) that the National economy requires that money rates be stabilized at an even lower rate. It is quite evident therefore that a revaluation of the properties of each of the fifteen unreorganized carriers would require an earning factor very much above that upon which the Plan is based even though it be assumed that there will be no higher income than was estimated in the period of the depression.

In most of the pending cases (and this is conspicuously true in the case of the Debtor) there are other new factors which permanently elevate earning power to a level far above that which could possibly have been estimated or predicated upon historical or current earnings.

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*STATEMENT SHOWING CHANGES IN INTEREST RATES REFLECTED BY RECENT REFINANCINGS OF RAILWAY LIEN INDEBTEDNESS

Name	*Date of Refinancing*	*Interest rate of old issue*	*Interest rate of new issue*
Chicago, Burlington and Quincy RR. Co.	Aug. 1–Dec. 1, 1944	4–5%	3½% 1½% 3¾%
Chicago and Northwestern Railway Co.	Jan. 1, 1945	4%	3%
Chicago Union Station Company	July 1, 1944	3½%	2⅝%
Erie Railroad Company	Oct. 1, 1944	3¾%–4%	3¼%
Great Northern Railway Company	July 1, 1944	4–4¼%	3¼–3½%
Great Northern Railway Company	July 1, 1945	3¾%–4½%	3⅛%
Louisville and Nashville Railroad Co.	Oct. 1, 1944	3½–3½%	3⅜%
Pennsylvania Railroad Company	Jan. 1, 1945	4½%	3⅛%

Foremost among these factors—and this is common to all of the fifteen cases—is the permanent elevation of National income. In order to service our great National debt it is a problem of the Government to maintain National income at an incredible level and it is almost *lese majeste* to assume that the Government will fail to achieve this result. Economists will also testify (if permitted so to do) that the industrial activity and expansion necessary to achieve such a National income would involve demands upon all forms of transportation even in excess of those created by the exigency of the War. This factor alone should preclude the use of historical or pre-war earnings to write down a Debtor's property investment as protected by the law of the land.

The Denver and Rio Grande Western System is, it should be added, in a peculiarly strong position to benefit by the new National economy. The more important reasons for this are summarized in the Opinion of Circuit Judge HUXMAN and are elaborated in the Opinion of Circuit Judge PHILLIPS. The attention of this Court is respectfully directed at this point to the following section of the Opinion of Circuit Judge PHILLIPS:

"Approximately $43,000,000 of the income available, but not used, for the payment of interest has

Name	*Date of Refinancing*	*Interest rate of old issue*	*Interest rate of new issue*
Pere Marquette Railroad Company	Mar. 1, 1945	4-5%	3⅜%
Union Pacific Railroad Co.	Oct. 1, 1944	4%	3%
Wabash Railroad Company	Feb. 1, 1945	4%	3¼%
Washington Terminal Co.	Feb. 1, 1945	3½-4%	2⅝%
Erie Railroad Company	Jan. 1, 1945	4%	3⅛%
Erie Railroad Company	Mar. 15, 1945	3⅛%	2%
Reading Company	Apr. 1, 1945	4-5%	3⅛%
New York Connecting RR.	Oct. 1, 1945	3½%	2⅞%
Lehigh & New England RR. Co.	Nov. 1, 1945	4%	3%
Western Maryland Ry.	Nov. 1, 1945	5½%	1¾%-3¼%
Pennsylvania Ohio and Detroit RR. Co.	Oct. 1, 1945	3¾%-4½%	2⅞%
Term. RR. Ass'n. of St. Louis	Oct. 1, 1945	3⅜%-4%	2⅞%

been expended in permanent improvements and betterments. While the investment value of the debtor's property thus was substantially increased, the Commission's valuation, based on estimated future earnings, was not increased proportionately. As a result, the claim of the senior security holders has increased and the participation of the general mortgage bondholders has been pressed downward until it is now fixed at 10 per cent of the new common stock. Many of the improvements and betterments referred to above, have substantially increased the capacity of the railroad to handle increased traffic as it arises. Central train control installed in many segments, where the greatest density of traffic obtains, gives to those segments, in a large degree, the equivalent of a double-track railroad and increases the number of trains that can be operated over the road and the volume of traffic that can be handled by the road. Other of such improvements have contributed to efficiency and economy in operations. These improvements have enabled the debtor to handle the great increase in traffic resulting from the war effort and have placed the debtor in a position to more economically and efficiently handle a volume of traffic largely in excess of its prewar traffic, should future economic conditions produce such traffic. Under the plan approved and confirmed by the district court, 90 per cent of the common stock goes to the holders of the senior securities and 10 per cent to the general mortgage bondholders. As a result, should there be a substantial increase in the debtor's postwar traffic over its prewar traffic, 90 per cent of the increased earnings will inure to the benefit of the holders of the senior securities and only 10 per cent to the general mortgage bondholders, whose claim was decreased 90 per cent by reason of the failure to discharge interest accruals with income available therefor and the diversion of such income to the cost of such permanent improvements. It seems to me, under all these circumstances, that, in addition to the other adjustments required to make the plan fair and equitable, the Commission should endeavor to modify the plan so as to give relief from the situation that lets the full impact of the improvement program fall

upon the claim of the general mortgage bondholders and accords them no corresponding benefits.

By confirming the finding of the Commission that the equities of the unsecured creditors and the stockholders are without value, based on an estimate of future earnings, an estimate at best shrouded in uncertainty, the court, by judicial fiat, has forever forfeited and destroyed the rights and interests of such creditors and stockholders in the assets of the debtor, a result which, under well-settled principles, a court of equity will ordinarily avoid.

It may be urged that the elimination of the stock will provide the debtor with a stronger financial structure and enable it to better serve the public interests, but private property cannot be taken in the public interest without just compensation.

Even if viewed solely from the standpoint of future earnings, it would seem that it should not be said such stock is without value merely because, during periods of receding economy and depression, the earnings of the debtor will not be sufficient, after payment of prior claims, to provide funds from which dividends on such stock can be properly paid. Such stock has value, if, during periods of expanding economy and prosperity, the earnings of the debtor will be sufficient to provide for prior claims and leave a surplus from which substantial amounts can be lawfully paid as dividends thereon; and a finding of no value should not be made if there is reasonable probability that earnings will be realized from which substantial dividends can be paid, even though only during periods of economic prosperity.

It seems to me, under the facts presented on this record and those of which we may take judicial notice, that it is not unlikely the estimate of future earnings of the debtor made by the Commission will fall far short of its actual future earnings. Should the estimated earnings prove to be substantially under the actual earnings, the injustice that will result to the holders of the general mortgage bonds and to the stockholders of the debtor is obvious.

It may be reasonably assumed that a substantial portion of the war industries contributing traffic to the road will be succeeded by permanent industries. For example, it is common knowledge that the Kaiser Industries and one of the large Eastern steel companies have indicated a desire to acquire and continue the operation of the Geneva Steel Plant, a large and modern steel plant built on the debtor's line of railroad. In the areas tributary to debtor's line of railroad, there is an abundance of cheap power and of fuel and ore. Many heavy traffic-producing enterprises have been and are being established in new areas tributary to the debtor's line of railroad. It is reasonable to believe that this industrial development will continue.

Furthermore, changes in national income at constant prices have an approximately constant relationship to changes in ton-miles of traffic. It may be said, in general, that traffic is so related to national income that when that income rises by one billion dollars, traffic rises by about 6.6 billion ton-miles. Certain federal agencies have made estimates of the national income for the years 1947 to 1949. These estimates predict a national income of approximately 135 billion dollars in 1947 and a rising national income in 1948 and 1949, reaching 150 billion dollars in the latter year.[3] This would indicate a postwar railroad traffic reaching in 1949 a level of that traffic during 1943.

Moreover, the ratio between ton-mile revenue of Class I railroads and the number of factory workers engaged in the production of durable goods is fairly constant. It is 100,000 revenue ton-miles for each factory worker. That there will be a determined effort to provide jobs for upward of 55 million workers early in the postwar period is a well-known fact. This indicates a greatly increased postwar railroad traffic. Moreover, the record demonstrates that, with the exception of a slight dip in 1923, the

[3] See Post-War Traffic Levels, prepared by Spurgeon Bell, Head Transport Economist, and I. E. Peabody, Principal Transport Economist, of the Interstate Commerce Commission, pp. 42-71, 90-114.

> debtor has been securing a constantly increasing proportion of the operating revenues of Class I railroads. If the debtor should enjoy postwar earnings approximating its 1943 earnings, it is clear that the valuation found by the Commission should be substantially increased."

The development and construction of the great steel plant at Geneva is alone a reason for a complete revaluation of the Debtor's properties and the formulation of a new Plan. The establishment of this industry on the Debtor's rails is certain to be revolutionary in its contribution to the new earning power of the Debtor's properties. Manifestly this and other things specified by Judge PHILLIPS should be the subject of scientific analysis and study and appraisal before there can be a fair and final determination either by an administrative Board or by a Court that the equity represented by the Debtor's stock is without value.

Let us here be specific because our properties are being taken from us upon the vaguest generalities.

The evidence shows and the Opinions of Judges HUXMAN and PHILLIPS each refer to capital expenditures made during the trusteeship aggregating more than $43,000,000 (Tr., p. 249; Annual Reports, 1935-1944). Only a negligible part of these expenditures had been made prior to the original valuation of the Debtor's properties by the Interstate Commerce Commission in its Report dated July 11, 1939 (Tr. 68; Annual Reports, 1936-1937). There was expert testimony of high quality that capital expenditures in the railroad industry are not deemed provident that yield an annual income rate below 10%. The witness said—

> "I spent several years with the Pennsylvania Railroad making economic studies of the savings it had out of new work, the added traffic to be obtained by new lines and extension of lines, and I know very well an improvement that didn't earn fifteen per

cent on its cost or was not estimated to earn fifteen per cent on its cost would receive no consideration whatever from the management, and I therefore assume that these improvements or most of them could be expected to earn ten per cent to fifteen per cent or even more in some cases" (Tr., pp. 316-317).

Applying the lower percentage an increased earning power of $4,300,000 is indicated as the result of the Court's capital investments. Capitalized at 4% this would increase the Commission's original estimate based on capitalizable earnings by adding thereto $107,500,000. This addition would increase the Commissions basic valuation of $147,717,268 made in its Report of July 11, 1939 to $254,717,268. To say that the Debtor's capital stock is worthless on the basis of a valuation made many years back and which frankly ignores this accretion to earning power alone condemns the Plan as both arbitrary and confiscatory.

There are other factors that lead to the same conclusion.

If it be assumed—and the assumption is a fair one—that the net income to be derived from new tonnage contributed by the steel plant recently constructed at Geneva combined as it should be with the increased net income furnished by the Utah Fuel Company would amount to only $2,000,000—and one-half of this is now being contributed by the Utah Fuel Company alone—and it be further assumed that this amount of increased net income is fairly capitalizable at 4%—and this is at least 1% above the current rate—there is an increase in capitalizable over-all value of $50,000,000. If the Commission's original valuation is increased to this extent the increase is sufficient under the Commission's Plan otherwise unchanged to make the General Mortgage Bondholders whole and provide a substantial equity for the Debtor's capital stock.

It is to be borne in mind that Section 77 is a part of the National Bankruptcy Act and so far as is consistent

with its purposes as a reorganization statute it should be administered in accordance with established bankruptcy principles.

One of the traditional bankruptcy principles coming over to us from England is that the rights of the parties are fixed as of the date of the filing of the petition and that the final decree relates back to the day when the Court took possession of the assets. On that day contracts end and the rights of the parties are *in rem*. In *Sexton* v. *Dreyfus*, 219 U. S. 339, in an opinion by Mr. Justice HOLMES this Court said at page 345:

> "If, under Section 57 of the present act, the value of the security should be determined by agreement or arbitration the time for fixing it naturally would be the date of the petition. At that moment the creditors acquire a right *in rem* against the assets. *Chemical National Bank* v. *Armstrong*, 59 Fed. Rep. 372, 378, 379. Merrill v. National Bank of Jacksonville, 173 U. S. 131, 140."

The philosophy of this rule is very fully developed by the decision of the Court of Appeals of New York in *People* v. *American Loan & Trust Co.*, 172 N. Y. page 371. We quote the following from the opinion in that case written by Judge VANN:

> "The process of administration provided by law is through a receiver, as the executive arm of the court. He is appointed for the benefit of all the creditors, both preferred and unpreferred, and holds the assets, under the direction of the court, in trust primarily for them and finally for the corporation or its stockholders. Thereupon by operation of law the creditors become the equitable owners of the assets and the administration of affairs is for their benefit as such . . .
>
> "As we said in a recent case, 'it is the day on which the court practically takes possession of the assets of the company for the purpose of distribution among its creditors and consequently (that) is the

day on which the rights of creditors should be ascertained and the value of their claims determined.' "

In *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131, it was pointed out by this Court that the Courts of the several States were not in agreement as to the precise time when jurisdiction of the bankruptcy court attached. Upon this point Chief Justice FULLER said:

> "In *Kellocks's* case, L. R. 3 Ch. App. 769, it was held that the creditor's interest in the general fund to be distributed vested at the date of presenting or proving his claim; and this rule has been followed in many jurisdictions where statutory provisions have been construed to require an affirmative election to become a beneficiary thereunder. For instance, the cases in Illinois construing the assignment act of that State, which are well considered and full to the point, hold that the interest of each creditor in the assigned estate 'only vests in him when he signifies his assent to the assignment by filing his claim with the assignee.' *Levy* v. *Chicago National Bank*, 158 Illinois, 88; *Furness* v. *Union National Bank*, 147 Illinois, 570.
>
> "On the other hand, the Supreme Court of Pennsylvania in *Miller's Appeal*, 35 Penn. St. 481, and many subsequent cases, has held, necessarily in view of the statutes of Pennsylvania regulating the matter, that the interest vests at the time of the transfer of the assets in trust."

In framing Section 77 of the National Bankruptcy Act Congress did not leave this question in doubt but with meticulous care and foresight it adopted and in subsection (l) *prescribed* for cases under Section 77 the rule that rights are fixed as of the date of the filing of the petition. This subsection provides:

> "In proceedings under this section and consistent with the provisions thereof * * * the rights and liabilities of creditors and of all persons with respect to the Debtor and its property shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

This established principle of bankruptcy and express provision of subsection (1) declaratory and confirmatory thereof has been disregarded in the pending proceeding to the manifest injury of the Debtor as well as its General Mortgage Bondholders.

As already shown the lowest valuation placed upon the Debtor's properties by the Interstate Commerce Commission based upon a record closed June 15, 1937, was $147,717,268.* There had been no substantial accretion to the *corpus* between that date and November 1, 1935, the date of the filing of the Petition (Annual Reports, 1936-1937). On November 1, 1935 the total amount of all claims of creditors secured by liens prior to the General Mortgage was $101,293,850, so that there was a trust estate sufficient to provide in full for all creditors having claims secured by such prior liens; to provide in full for $29,808,000 principal amount of General Mortgage Bonds and to provide an equity for the Debtor's stockholders in the amount of $16,615,418 (Annual Report, 1935, pp. 13, 34).

Let us repeat: the interests of the parties were fixed in these amounts by both the fundamental rule of bankruptcy long ante-dating subsection (1) and by subsection (1) and the law has been flagrantly violated.

In respect of the claim of General Mortgage Bondholders for principal in the amount of $29,808,000 *plus* their proportionate share of increment during trusteeship which without equitable adjustment was not less than $9,389,418 at the end of the calendar year 1944 these Bondholders are offered $4,353,816 in common stock and the equity of the Debtor's capital stock which stood at $16,615,418 on the date when the rights of all parties were fixed both by the

* The Commission has developed four different Plans which assume three different valuations:—Report July 11, 1939—$147,717,268; Report April 2, 1940—$147,717,269; Report July 13, 1942—$154,521,612; Report June 14, 1943—$155,173,127 (Transcript, pp. 68, 106, 124, 156). Our references to these assumed valuations in this Brief must not be construed as an admission that they are valid or conform to due process. We contend otherwise.

bankruptcy rule and by subsection (1) is declared to be worthless.

This might indicate that the property had depreciated during trusteeship but such is not the case. Subsequent to basic date not less than $43,000,000 of earned income had been invested in the property in the process of judicial administration. The earned income exceeded the accumulation of contract interest on senior debt and greatly exceeded what a court applying bankruptcy principles could be expected to allow such creditors in lieu of contract interest, and it will now be in order to discuss the income problem.

As shown by the authorities cited above it is a basic principle of bankruptcy confirmed for cases under Section 77 by subsection (1) that rights are fixed as of the date when the bankruptcy court takes judicial custody of the *res* and as a corollary interest as such ceases to accrue on that date.

As between creditors themselves therefore there is no accumulation of interest *pendente lite*. In the final adjustment an equitable participation in any increment or accretion to the trust estate in excess of the principal of creditor claims is allowed each creditor and we think a just and equitable rule requires the division to be made at a uniform rate. In England by the Act of Parliament adopted in 1883 a uniform rate of 4% is provided. The pertinent text follows:

> "(4) Subject to the provisions of this Act all debts proved in the bankruptcy shall be paid pari passu.
>
> "(5) If there is any surplus after payment of the foregoing debts, it shall be applied in payment of interest from the date of the receiving order at the rate of four pounds per centum per annum on all debts proved in the bankruptcy."
>
> (Law Reports, 46-47 Viet., 1883, Statutes Vol. 19, Ch. 52, Sec. 40, Subsec. 4 and 5.)

There is a question whether the rate should be frozen as it has been by Parliament. Interest rates are too volatile and respond to too many changing factors. The creation of a great National debt as has been done in England as well as here is but one of many factors which lead to the conclusion that the rate is best left to the informed judgment of the Chancellor. The reason for this rule is explained by the Court of Appeals of New York in the opinion of Judge VANN cited above. On this further point Judge VANN says (p. 379):

> "If the funds in the hands of the court could have been distributed on the same day that the receiver was appointed, no claim of interest could have arisen, for there would have been no delay and no suspension of legal remedies. The delay in distribution, however, was the act of the law itself, and was essential for various purposes and among others to enable the creditors to prove their claims. 'As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds.' (*Thomas* v. *Western Car Co.*, 149 U. S. 116.) Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets. If the assets are sufficient to pay all, including interest, it must be paid, for as against the corporation itself interest should be allowed before the return of any surplus to the stockholders. As between the creditors themselves, however, no interest should be allowed during the process of administration, and the delay necessarily resulting therefrom, because the assets are equitably their assets, the administration is for their benefit and the delay is necessary to enable them to take action to present their claims in proper form, as well as to enable the court to put the assets in shape for distribution.
>
> "As the decree of dissolution relates back to the day when the court took possession of the assets, the delay is not the act or omission of the corporation, which is *civiliter mortuus*, but is owing to the law

and hence should operate neither to benefit nor prejudice any creditor. Distribution should be made as of the date when the delay began, for it was not only caused by the law but was necessary for the protection of all classes of creditors. As between the creditors themselves, therefore, interest ceases to accrue upon their respective claims, whether preferred or unpreferred, from the day when the corporation let go and the court took hold. This rule is so simple and easy of application that it will not only tend to prevent litigation, but will stimulate all creditors to frown upon delay and to promptly call the receiver to account. It will not induce preferred creditors to rest easy in reliance upon the expectation that they will make money through the misfortune of the corporation and, during the entire period of administration, receive interest at a greater rate than they had contracted for."

Reference should here be made to the decision on this question in *Board of Commissioners of Shawnee County, Kansas* v. *Hurley, et al.* (169 Fed. Rep. 92). The Opinion is written by Circuit Judge WALTER H. SANBORN and is liberally fortified by authorities. On points pertinent in the instant case Judge SANBORN says (p. 94):

"In the discussion of this question preferences, securities consisting of pledged or mortgaged property, such as are required to be surrendered or applied upon claims by the bankruptcy law, are laid out of consideration, and what is said has no reference to rights under them, because no such rights are in issue here. Laying out of view then such preferences and securities, the status of claims at the time of the filing of the petition in bankruptcy, and not at any subsequent time, fixes the rights of their owners to share in the distribution of the estate of the bankrupt. Bankr. Act. July, 1898, c. 541, Sec. 63a(1), 30 Stat. 562 (U. S. Comp. St. 1901, p. 3447); *Swarts* v. *Siegel*, 117 Fed. 13, 15, 54 C. C. A. 399, 401; *In re Bingham* (D. C.), 94 Fed. 796. On that date the property of the bankrupt passes from his control to the court or to its receiver, and thence

to the trustee in trust for the creditors of the bankrupt in proportion to the amounts of their claims at that time. On that date there vests in each creditor as a *cestui que trust* an equitable estate in such a part of the property of the bankrupt as the amount of his provable claim at that time bears to the entire amount of the provable claims against the estate. *On that date the bankruptcy law deprives the creditor of all his common-law remedies to collect his debt out of the property of his debtor and to collect subsequent interest on his claim against that property, and gives him in lieu thereof this equitable estate in the property of the bankrupt.* Thus the filing of a petition upon which a subsequent adjudication of bankruptcy is rendered places all the property of the bankrupt 'which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him' in *custodia legis.* Section 70a(5), 30 Stat. 566 (U. S. Comp. St. 1901, p. 3451). From that hour the bankrupt is divested of the power to appropriate it to the payment of his debts or to use and dispose of it at will, and that authority is vested in the District Court. Every suit against him upon a provable claim is stayed from the date of the filing of the petition. Section 11a, 30 Stat. 549 (U. S. Comp. St. 1901, p. 3426). Every person is forbidden to receive from the bankrupt any material amount of property after that date with intent to defeat the act. Section 29b, 30 Stat. 554 (U. S. Comp. St. 1901, p. 3433). Every intentional preference after that date is voidable. Section 60b, 30 Stat. 562 (U. S. Comp. St. 1901, p. 3445). Upon the filing of the petition the court may take immediate possession of the property if the bankrupt is neglecting it so that it is deteriorating in value. Section 69a, 30 Stat. 565 (U. S. Comp. St. 1901, p. 3450). And upon the appointment of the trustee all the property of the bankrupt 'which, prior to the filing of the petition, he could have transferred, or which could have been seized or sold under judicial process against him, passes to this officer of the court. Section 70a(5). Indeed, the condition at the time of the filing of the

petition measures the extent of the estate and the rights of all creditors of the bankrupt and all parties interested in the property throughout all the provisions of the law. Sections 1(10), 3b, 9b, 29(4), 68a(1), 30 Stat. 544, 546, 549, 554, 562 (U. S. Comp. St. 1901, pp. 3419, 3422, 3426, 3447)."

In proceedings under Section 77 there are certain new factors—first, the ultimate aim is reorganization rather than liquidation; and second, there has been introduced into proceedings under Section 77—perhaps in recognition of the complicated capital structures to which reorganization is to be applied—the use of different kinds and grades of securities designed to preserve creditor priorities as they existed at the inception of the proceeding.

The most that creditors could claim under Section 77 in preservation and protection of any lien priorities in respect of income *pendente lite* would be that each be given in the distribution of such income the same kind and grade of securities given him for principal of his claim at basic date. This would narrow the income problem down to the single question of the fair and equitable rate. In fixing the rate for the distribution of income among the different classes of creditors the Court gives consideration to many factors. In cases such as this one, which has been delayed many years by litigation between the senior creditors, a low rate should be indicated. Money rates current during the period of the delay should receive weight. Respect also should be accorded the views of the parties in interest who themselves should be the ones to propose a new Plan and fix the rate to be allowed on claims *pendente lite*. Here the dominant fact is that the property is theirs and the Court should give weight to their views as to what is equitable and just. In the present case the problem is simplified by the fortitous circumstance that income *pendente lite* is in excess of contract interest and 4% would be deemed a generous rate by creditors.

On facts of record as to which there is no dispute there would be no difficulty in formulating a Plan utilizing the Commission's basic valuation of $147,717,268 which would give due recognition to all creditors and stockholders and be compatible with the public interest.

Such a Plan would give recognition to all of the indebtedness of the Debtor as it existed November 1, 1935, in the amount as heretofore shown of $131,101,850—this being the aggregate of senior claims: $101,293,850 and the principal of the General Mortgage Bonds: $29,808,000. To this amount should be added income for ten years—from November 1, 1935 to November 1, 1945 measured by a fair percentage of principal which should not exceed 4%.* 4% would indicate an accretion of $52,440,740 as of November 1, 1945 and an allotment of new securities to creditors in the amount of $183,542,590 which would make all creditors whole and at the same time leave an equity for the stockholders in the amount of $16,615,418 without increasing the Commission's original basic valuation. The underlying principle of such a Plan would be that recognition up to $52,440,740 in new securities should be given for increased current assets and other accretions and for capital investments made by the Court.

The Debtor believes that such a Plan could be promptly negotiated with all creditors and put into effect without any delay unless head winds are met in the Interstate Commerce Commission. Added value due to economic changes between November 1, 1935 and November 1, 1945 far in excess of $52,440,740 could easily be justified—indeed an additional valuation substantially below that figure would indicate that much of the $43,000,000 spent on the property during trusteeship had been wasted.

* Income available for interest accrued to December 31, 1945 in the amount of $49,420,972 as shown by Annual Reports does not reflect heavy earnings of the Utah Fuel Company and various wholly owned subsidiaries; nor does it reflect income carried in reserves for which the necessity remains to be demonstrated.

In the formulation of the new Plan of Reorganization the rights of the Debtor, its junior creditors and stockholders in the capital stock of the Utah Fuel Company should be respected in the observance and not in the breach. Their rights are clear. The stock is pledged under the First Consolidated Mortgage of The Rio Grande Western Railway Company at a valuation of $6,000,000. The junior interests are entitled to withdraw their stock from pledge at this valuation or to have it sold at an upset price of $6,000,000 or (assuming but not admitting that appraisement is a constitutional substitute for a public sale for which the parties have expressly contracted) to have the stock separately valued in accordance with the law of the land which requires the independent judgment of a judicial tribunal upon both the law and the facts. Those of us whose admiration for the Interstate Commerce Commission is of the highest do not concede that it possesses expert qualifications for the appraisal of a coal operation in the State of Utah. The Plan should provide that any realization in excess of $6,000,000 be credited to the highest ranking junior creditor not made whole under its provisions and that this particular adjustment be made by payment in cash or in the most senior new security issued under the Plan. We think a public sale is the method less likely to involve constitutional infirmities and the one that should be pursued in view of the problems under the Commodities Clause of the Interstate Commerce Act which may arise if the Utah Fuel Company is not wholly divorced from carrier ownership (49 U. S. C. A. 1(8)).

Conclusion

In view of what is said in the Report of the Judiciary Committee and in the Opinions of Circuit Judges HUXMAN and PHILLIPS and of the newly informed judgment and judicial knowledge of this Court, it is respectfully submitted

that the proceeding should be referred back to the Interstate Commerce Commission in accordance with the direction of the Circuit Court of Appeals for the formulation of a new Plan as outlined above. The Opinions and Order of the Circuit Court of Appeals show a keen understanding that whatever the complicated scheme of Section 77 may be the Plan as made and the principles underlying its making need a plenary resurvey.

Respectfully submitted,

February 15, 1946.

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Appendix A

A Critical Analysis of Recent Reorganization Decisions of the Supreme Court of the United States†

FRANK C. NICODEMUS, JR.

In his dissenting Opinion in *Northern Securities Company* v. *United States*[1] the late Justice HOLMES has given us the oft-quoted epigram: "Great cases like hard cases make bad law." *Case, et al.* v. *Los Angeles Lumber Products Company, Ltd.*[2] was a hard case that has made bad law. The case was hard because first lien Bondholders having a valid debt of $3,807,071.88 secured by a prior lien on property having an appraised value of $830,000 were given new Preferred Stock for only $641,375—less than 25% of the full claim—under a Plan of Reorganization which allotted to junior interests (referred to as Class A Stockholders) a junior stock representing the balance of the appraised value of the mortgage estate.

The Plan had been approved and accepted by 92.81% of the first lien Bondholders and approved as fair and equitable by the District Court. The judgment of the District Court was affirmed by the Circuit Court of Appeals. The reorganization went on the rocks in the Supreme Court which condemned the Plan as unfair and inequitable because the first lien Bondholders were not given new securities for the full value of the property.

If that were the whole story; if the balance of the new securities representing $188,625 of the total value of the property had been given gratuitously to the junior interests the case would not make bad law. The District Court had found, however, that the allotment of a subordinate stock to the junior interests in the amount of $188,625 was supported by an adequate consideration. The Supreme Court

† This analysis was prepared for use of the Congress at the request of the Honorable HATTON W. SUMNERS, Chairman of the Judiciary Committee of the House of Representatives.

[1] 193 U. S. 197 (p. 400).

[2] 308 U. S. 106.

did not have before it the record that was before the District Court but nevertheless held that the considerations specified by the District Court, one of which was "continuity of management" constitute no legal justification for the issuance of the new stock to them. "Such items," the Court said, "are illustrative of a host of intangibles which if recognized as adequate consideration for issuance of stock to valueless junior interests would serve as easy evasions of the principle of full or absolute priority of *Northern Pacific Ry. Co.* v. *Boyd*[3] and relates cases." This determination pushes far too far the doctrine of these cases in none of which did any question of value arise and it applies to a reorganization the rigid rules applicable to a liquidation which it is the very purpose of a well conceived reorganization to avoid. Lien creditors ordinarily are investors whose objective is to remain in the enterprise as such and to assume no responsibility for management. To this end the lien creditor is permitted to make concessions in reorganizations to subordinate or equity interests which in a liquidation would be inadmissible. An examination of reorganizations over a period of fifty years will disclose hundreds of cases where lien creditors have accepted less than they would have received in liquidation in order to continue the enterprise and remain in it in an investor status. Income Bonds and Preferred Stock have been substituted for fixed interest bearing bonds frequently at lower interest or dividend rates and non-cumulative. Concessions such as these preserve for the investor the going concern value of the enterprise without changing his own status or requiring him to take over the burden of management and have heretofore been regarded as reasonable departures from the doctrine of strict priority. These factors motivated the first lien Bondholders of the *Los Angeles Lumber Products Company, Ltd.* in carving out of their own mortgage estate for the benefit of Class A Stockholders a new junior stock in the amount

[3] 228 U. S. 482.

of $188,625. They may have made a bad deal. The Supreme Court apparently thought they had made a bad deal, although the District Court had thought otherwise. The question, however, is one of business judgment and arises in an area where business judgment may lawfully be exercised and where a minority is protected by the self-interest of the majority.

Consolidated Rock Products Company v. *DuBois*[1] goes further than any previous case in its exploitation in reorganization of the doctrine of absolute priority. A Plan of Reorganization under Section 77B had been confirmed as fair and equitable by the District Court but on appeal was remanded by the Circuit Court of Appeals upon the sound and salutary ground that the Order or Decree of approval was not supported by detailed findings. In its Opinion, however, the Circuit Court of Appeals "made certain statements" which the Supreme Court thought did not "comport with the requirements of the absolute priority rule." The Supreme Court approved the reversal of the District Court but issued writs of *certiorari* "because of the importance in the administration of the reorganization provisions of the Act of certain principles enunciated by the Circuit Court of Appeals."

An analysis of the Opinion of the Supreme Court written by Mr. Justice DOUGLAS discloses three major propositions which the Supreme Court constructs upon the doctrine of absolute priority.

These are: (a) that a reorganization is unfair and inequitable which fails to treat interest on a parity with principal; (b) that a reorganization is unfair and inequitable which fails to accord "full compensatory treatment" to senior creditors who are asked to make sacrifices; and (c) that a reorganization is unfair and inequitable which gives recognition to junior interests unless supported by a valuation based upon "capitalization of prospective earnings."

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[1] 312 U. S. 510.

Each of these propositions which will be discussed briefly in its order is a departure from or an addition to the doctrine of strict or absolute priority as it has heretofore been applied in equity:

(a) *Interest:* The Plan of Reorganization which the Supreme Court condemned provided for the issue to senior lien creditors of Income Bonds and Preferred Stock (50% of each) for the full principal amount of their respective claims but made no provision for accrued interest which was extinguished under the Plan. The Supreme Court thought that this ran afoul of the absolute priority rule because "interest is entitled to the same priority as principal," referring as authority to the cases set out below.[5] These cases hold that the mortgage lien secures interest equally with principal and would fully sustain a ruling according interest parity of treatment with principal in a liquidation; but such treatment of interest is contrary to the established practice in equity reorganizations and to the finer traditions of our jurisprudence. What the Supreme Court has overlooked is that a contract for the payment of interest is different from almost every other contract known to the law. Since the dawn of history a contract for the payment of money for the use of money has been *sui generis*. Such a contract has always been subject to rigid governmental regulation and at times was completely outlawed by both the Jewish Church and the Christian Church. Under the Jewish Ecclesiastical Law up to the time of Rabbi Hillel forgiveness of a debt was mandatory after seven years and forgiveness of debt as a tenet of Christianity is uttered daily by millions in the Lord's Prayer. Interest problems perplexed the Athenians at the time of Solon nearly 600 years before the Christian Era. Later in Rome the subject was dealt with in the XII Tables which fixed a maximum rate of 8⅓%. But notwithstanding this Rome within a Century had become so debt ridden that the Government itself took over all

[5] *American Iron and Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, 266, 267; *Ticonic National Bank* v. *Sprague*, 303 U. S. 406.

loans that were well secured and persuaded the holders of loans that were undercollateralized to accept lower interest rates and give to their unfortunate debtors the same kind of relief that was in the minds of Congress when it adopted Section 77 and Section 77B of the National Bankruptcy Act. In the Christian Era at the time of Marcus Aurelius the legal rate had risen to 12% and as the Emperor deemed this rate unconscionable he proceeded to drive the rate down by offering Government loans at 4%; and that is precisely what our own Government did in the early days of Reconstruction Finance Corporation. In England maximum rates were fixed from time to time by Parliament although there were periods in which Parliament, as did Solon, left the rate to be fixed by contract of the parties; but in the English Chancery Court the statutory rate was not binding. The Chancellor would not enforce a rate so far out of line with the prevailing commercial rate as to seem oppressive. Interest rates move up and down in response to the rise and fall of the National economy and thus it has been throughout history. It is not possible to fix an interest rate for a long period of years that will not become unfair before the time ends. Part of the time it will be too high, part of the time too low. It was the spirit of the common law as it came over to this Coun y from England that only contracts for reasonable interest were valid; and the laws and the literature of all civilized countries have encouraged leniency on the part of creditors. Yet the Supreme Court has apparently taken the position that it is unfair and inequitable for 66⅔% of a group of creditors to forgive all or any part of unearned or excessive contract interest due from a group of less fortunate debtors. The effect of the determination would seem clearly to be to overrule the Lord's Prayer and to issue posthumously to Shylock a patent of nobility. That the Supreme Court made its determination inadvertently and not deliberately may fairly be inferred from the circumstance that the Supreme Court

itself in the case of *Canada Southern Railway Company* v. *Gephard*[6] had approved as fair and equitable a Plan of Reorganization under which various Bondholders, some holding First Lien Bonds, others Second Lien Bonds, waived *all* interest and accepted in full settlement a new Bond at par for the principal of their debt.

(b) *Full Compensatory Treatment:* In the Opinion of the Supreme Court in *Northern Pacific Railway Company* v. *Boyd*[7] written by Mr. Justice LAMAR which has been referred to in the cases under review as the foundation of the doctrine of "absolute priority", there is the following statement:

> "This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or Preferred Stock. If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and having refused to come into a just reorganization could not thereafter in a court of equity be heard to attack it."

This does not say or imply that the creditor "must be given full compensatory treatment and be made whole." The implication is precisely the reverse because there is but one method of measuring "full compensatory treatment" and that is by lawful money of the United States and this the Court expressly excludes. The traditional test of fairness is not the dollar measure but the preservation of the *priority* and this the Court says may be done by resort to an income bond or a Preferred Stock. To require that income bonds and Preferred Stock be issued in such quantity as to make the creditor whole is quite

[6] 109 U. S. 527.
[7] 228 U. S. 482.

obviously "to do the impossible." On the faith of an interpretation of *Northern Pacific Railway Company* v. *Boyd* which excluded the impossible there were many sound and successful reorganizations carried through in the earlier days in equity and more recently under Section 77B before the decisions of the Supreme Court in the cases under review. In many of these the senior lien creditor accepted an income bond or Preferred Stock for principal, waived interest for the depression period in which no interest was earned and left the equity undisturbed. In other cases the equity interests gave a part of their equity to the creditors or a Preferred Stock for unearned interest. There were a variety of Plans put through quickly that were satisfactory to all interests but which could not be sustained under the subsequent decisions of the Supreme Court. One of the last to get under the wire as will be seen from Moody's Industrial Manuals for 1937-1938 was the Baldwin Locomotive Works which contributed so much to our successful prosecution of the War and which is giving splended returns to the equity interests that would have been impoverished by a reorganization conforming to the subsequent decisions of the Supreme Court.

(c) *Capitalization of Prospective Earnings:* In *Smyth* v. *Ames*[8] the Supreme Court mentioned "the probable earning capacity of the property under particular rates prescribed by statute" as one of the many factors that might be considered in the ascertainment of the "fair value of the property" employed in the public service. This was not specified as a basic element but was relevant to the factor of "going concern value." If it had been regarded as a basic element of value its use would have created the "vicious circle" referred to in the dissenting Opinion in *Southwestern Telephone Co.* v. *Public Service Commission.*[9] The law of the land as to the ascertainment

[8] 169 U. S. 466.
[9] 262 U. S. 276.

of "the fair value" protected by due process was finally settled (or thought to be) by the Opinion of former Chief Justice HUGHES in the *Minnesota Rate Cases*.[10] Here the Supreme Court accepted reproduction cost less depreciation as the basic element of such a value but even this it did with the following reservation:

> "The cost-of-reproduction method is of service in ascertaining the present value of the plant when it is reasonably applied and when the cost of reproducing the property may be ascertained with a proper degree of certainty. But it does not justify the acceptance of results which depend upon mere conjecture."

The subject was reconsidered in the *Southwestern Telephone* case and in *St. Louis and O'Fallon Railroad Company* v. *United States*.[11] In these last mentioned cases Mr. Justice BRANDEIS sought to have the Supreme Court overrule *Smyth* v. *Ames* and substitute for the law of the land a new measure of value based upon prudent investment which he urged in two monumental dissenting opinions possesses the merit of certainty and stability said to be lacking in valuations under *Smyth* v. *Ames*. In neither of these opinions is it suggested that a valuation might be based upon capitalization of earnings; on the contrary the Justice objected to any consideration of regulated earnings as creating the "vicious circle." While it is true that factors other than reproduction new less depreciation may be considered as possible elements of value (certain of these are summarized in Note No. 6 to the dissenting opinion of Justices BRANDEIS and HOLMES in the *Southwestern Telephone* case) it is used as a basic, if not the basic factor, in all of the leading cases which involve confiscation to the extent that it may be ascertained with a proper degree of certainty and without conjecture.

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[10] 230 U. S. 352.
[11] 279 U. S. 461.

It may be here noted that there could be no mode of valuation resting more completely upon conjecture than capitalization of prospective earnings but since the decision of the Supreme Court in the case under analysis other methods are being discarded, although it would have been constitutionally bad for Congress to have prescribed such a method of valuation if it had tried to do so.[12]

The Railroad Reorganization Cases[13] referred to herein as the *Western Pacific* case and the *Milwaukee* case were argued together at the 1942 Term of the Supreme Court and were decided on March 15, 1943 under separate correlated Opinions, one by Mr. Justice REED rendered in the *Western Pacific* case, the other by Mr. Justice DOUGLAS rendered in the *Milwaukee* case. In each case the District Court had approved a Plan of Reorganization under Section 77 which the Circuit Court of Appeals reversed for lack of detailed findings deemed imperative under the ruling of the Supreme Court in *Consolidated Rock Products Co., Ltd.* v. *DuBois*. The Supreme Court granted *certiorari*. In the *Western Pacific* case it reinstated the Order of the District Court. In the *Milwaukee* case it reversed the Circuit Court of Appeals for requiring findings but allowed the case to be referred back to the Interstate Commerce Commission to reconsider the question whether the senior lien creditors who had insisted that the Plan accorded them full compensatory treatment had not dealt with themselves too ungenerously.[14]

The necessity for findings had been urged as being even more pressing in these cases than in *Consolidated Rock*

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[12] *Monongahela Navigation Co.* v. *U. S.*, 148 U. S. 312, and case cited under note 18.

[13] *Ecker, et al.* v. *Western Pacific Railroad Corporation*, 318 U. S. 448; *Group of Institutional Investors, et al.* v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, 318 U. S. 523.

[14] Afterwards there was an *opera bouffe* performance in the Interstate Commerce Commission where the senior creditors asserted that they had been "defeated" in the Supreme Court in their contention that they had been "made whole" and forthwith laid claim to some $15,000,000 of additional cash which the Interstate Commerce Commission graciously gave them.

Products Co., Ltd. v. *DuBois* for the reasons which the Supreme Court had assigned in that case.

The Supreme Court nevertheless held that while requirements for valuation are the same in a proceeding under Section 77 as in a reorganization under Section 77B it did not think there was anything in the *DuBois* case "to indicate that dollar valuations of the property or claims are essential for recapitalization or distribution of securities in reorganization." The fact that in the *Milwaukee* case the line of railway separately built and separately mortgaged and stretching from the Missouri River to Puget Sound was being taken without any valuation from the lienor and placed under a new mortgage in which the lienor was given no participation had not impressed the Supreme Court as having significance.

The opinions in these cases are fairly limited to questions presented by the record but it was obviously the intention of the Supreme Court that they should serve as a comprehensive guide to the Interstate Commerce Commission and the District Court in their future proceedings under Section 77.

Underlying both of these opinions is the proposition developed by the Supreme Court in its interpretation of Section 77 that Congress had intended to give the Interstate Commerce Commission the exclusive jurisdiction (1) to determine the value of a Debtor's property for the purpose of reorganization; (2) to determine the character and amount of reorganization capital; and (3) to determine the compatability of the reorganization with the public interest. These determinations the Supreme Court thought were to be final subject only to the limited judicial review which, in prior legislation Congress had prescribed for all determinations for the Interstate Commerce Commission. Mr. Justice ROBERTS and Mr. Justice FRANKFURTER dissented on the ground that a broader judicial review was necessary.

The Judiciary Committee of the House of Representatives in a formal official report has taken the position that the interpretation placed upon Section 77 by the Supreme Court as above summarized is contrary to the intent of Congress.[15] Since the Judiciary Committee speaks of actual knowledge it must be concluded as a fact that the Supreme Court was wrong; however justifiable its interpretation may seem in view of the complex provisions of Section 77.

This analysis is an effort to show why and where the Supreme Court went wrong and to suggest what may be done to quiet an aroused Congress and make Section 77 the useful and workable legislation which Congress had visualized.

The reason why the Supreme Court went wrong is that its approach to the problem of interpretation involved an apparent predisposition to give maximum power to the Interstate Commerce Commission and minimum power to the Court. Congress had not intended this if its intention is to be ascertained by the text of Section 77 construed in accordance with accepted canons of statutory construction.

The critical point where the Supreme Court went wrong was at the very beginning of Mr Justice Reed's opinion in *The Western Pacific* case which rejects the following constitutionally sound interpretation of Section 77 developed by the Circuit Court of Appeals:

> "In determining whether a plan of reorganization satisfies the requirements of subsection e, the court is not concluded by any determination made by the Commission, but may, and must, exercise its own independent judgment; and this is true whether such determination relates to value or to some other subject. Initially, however, the duty of determining the value of any property for any purpose under Section 77 rests on the Commission, not on the court. In re Western Pacific R. Co., 124 F. 2d, 136, 140."

[15] Report of the House Judiciary Committee on H. R. 4960, Seventy-Eighth Congress, Second Session, Report No. 1615.

Each of the three points where the Supreme Court held the Commission's jurisdiction to be exclusive to the extent indicated will be briefly analyzed under the captions (1) Valuation; (2) Capitalization; and (3) Public Interest, reserving for limited discussion at a subsequent point the question whether and to what extent appraisement is a valid substitute for public sale.

(1) *Valuation.* In the concluding paragraph of subsection (e) is the following provision for valuation:

> "If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

The interpretation of this very vital provision falls in two categories—first, the *finality* of the Commission's valuation thereunder; and second, the *method* of its valuation.

First, as to *finality*:—Referring to this category Mr. Justice REED in his opinion in the *Western Pacific* case notes that valuation is not specified in the first paragraph of subsection (e), as one of the subjects upon which the Court is required to make findings although it is also noted that a finding by the Commission that the equity or interest of a particular class of creditors or stockholders is without value is required by a subsequent paragraph of the same subsection to be affirmed by the Court. From the general

premise thus set up together with citations from the testimony in the Judiciary Committee of the House of Representatives Mr. Justice REED draws the following conclusions as to the finality of the Commission's action:

> "The power of the court does not extend to participation in all responsibilities of the Commission. Valuation is a function limited to the Commission, without the necessity of approval by the court. The first sentence of the last paragraph of subsection (e) provides:
>
> 'If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan.' The function of valuation thus left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise. One of the primary objects of the bill was the elimination of obstructive litigation on the issue of valuation and the form finally chosen approached as near to that position as seemed to the draftsmen legally possible. Judicial reexamination was not considered desirable. None of the findings required of the judge under subsection (e) relates specifically to valuation. Congress apparently intended to leave the determination of valuation 'of any property for any purpose under this section' to the Commission. The language chosen leaves to the Commission, we think, the determination of value without the necessity of a reexamination by the court, when that determination is reached with material evidence to support the conclusion and in accordance with legal standards. It leaves open the question of whether in reaching the result the Commission had applied improper statutory standards. This latter point is discussed under the heading of *Method of Valuation* in this opinion, p. 477, infra, where this plan is reviewed and upheld in this respect."

> "Assuming at this point that the Commission's valuation is sound and reached by allowable methods,

a matter discussed later in this opinion at page 477, we hold that the elimination of the claims of stockholders and creditors which are valueless from participation in the reorganization is in accordance with valid provisions of Section 77 (e). Actual bankruptcy means a loss to some investors. Subsection (e) recognizes this inevitable result and provides a method for their elimination from the reorganization proceedings."

"While by the terms of the statute the valuation of the property is left to the Commission, without participation by the court, this valuation must be made in accordance with the direction of the statute and as to that valuation is subject to judicial review. This review is limited in character by the direction of subsection (e) that valuation shall be determined by the Commission. The District Court may review to determine whether the Commission has followed the statutory mandates of subsection (e). Subsection (e) requires valuations by the Commission to be 'determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.' Thus, while judicial review does not involve an independent examination into valuation, it does require that the court shall be satisfied, upon the record before the Commission, with such additional evidence as may be pertinent to the objections to the Commission's finding of value, that the statutory requirements have been followed."

In reaching the conclusions set out above Mr. Justice REED appears to have given no weight to established canons of construction which if used would lead to a different conclusion from that which he reached. The Justice also

relied upon references to evidence before the Judiciary Committee which fall short of supporting the text of the Opinion.[15a]

A basic rule of construction asserting itself *in limine* and to which Mr. Justice REED gave no weight is the rule which requires a statute to be construed so as to avoid grave constitutional questions. Referring to this rule Chief Justice WHITE said:[16]

> "It is elementary when the constitutionality of a statute is assailed, if the statute be reasonably susceptible of two interpretations, by one of which it would be unconstitutional and by the other valid, it is our plain duty to adopt that construction which will save the statute from constitutional infirmity. *Knights Templars Indemnity Co.* v. *Jarman*, 187 U. S. 197, 205. And unless this rule be considered as meaning that our duty is to first decide that a statute is unconstitutional and then proceed to hold that such ruling was unnecessary because the statute is susceptible of a meaning, which causes it not to be repugnant to the Constitution, the rule plainly must

[15a] In support of the statement: "Judicial reexamination was not considered desirable" Justice REED refers to the hearings on H. R. 6249, pages 249-50; 291-92; 317. Much that is here said was in relation to the Commission's determinations of physical values under 19a and not over-all valuation under subsection (e). At pages 249-50 Chairman Sumners asked Mr. Fulbright (Railway Counsel) whether it could be constitutionally and practically arranged that the valuation in these proceedings be fixed by the Interstate Commerce Commission." Mr. Fulbright thought (with qualifying conditions) that it could; but he was afraid "that under this bill we would have to try the whole thing over again in the court and I do not think that ought to be done." So what Justice REED says may correctly reflect the state of mind of Mr. Fulbright but it manifestly does not state the view entertained by Chairman Sumners. At pages 291-292 the Chairman and a Committeeman (Mr. Robison) pursued the same inquiry. Following a series of questions directed to Mr. Marcus L. Bell, a member of the Committee of lawyers representing the Association of American Railroads, Mr. Robison finally asked: "Do you think we could write into the statute making the finding of fact—which is the finding of fact by the Commission—on valuation final?" to which Mr. Bell replied: "No, sir, I need only cite the O'Fallon case." At page 317 Mr. Leslie Craven speaking for Mr. Eastman says the final word: "I do not know that I understood Mr. Bell but t... have been views expressed here that you could delegate the valuation to the Commission for its final determination. That would perhaps be wise; I do not know that it would. But we doubt the constitutionality of it. We do not think you can submit to the Interstate Commerce Commission the final determination of that judicial issue."

[16] *United States* v. *Delaware & Hudson Co.*, 213 U. S., page 361, at 407-408.

> mean that where a statute is susceptible of two constructions, by one of which grave and doubtful constitutional questions arise and by the other of which such questions are avoided, our duty is to adopt the latter. *Harriman* v. *Interstate Com. Comm.*, 211 U. S. 407."

It must be assumed that the Judiciary Committee of the House of Representatives were conscious of this rule when they framed the concluding paragraph of subsection (e).

The first question therefore to be determined in reaching a sound construction of this paragraph is how far Congress can go within the limitations of the Constitution in giving finality to a valuation placed upon private property in a proceeding between private litigants not involving the eminent domain by an administrative board of laymen serving for limited terms under executive appointment confirmed by the Senate.

The answer to this question which may be given readily and categorically is different from that given by the Supreme Court in the decisions under analysis. The correct answer is:

Congress may give such a board jurisdiction to fix such a valuation with finality and without judicial review only when its use does not involve the taking of private property.

Ordinarily this allows finality and excludes judicial review of any valuation under subsection (e) which is high enough to provide full participation for all creditors and stockholders. This is a reason, if not the reason, why the Judiciary Committee of the House did not specify valuation as one of the factors to be dealt with in the findings of the Court. The taking of private property is not involved where recognition is given in reorganization to all creditors and stockholders and this, it may be added, is the kind of a reorganization which Congress had in mind

when it enacted Section 77 and Section 77B and later the Chandler Act—all "for the relief of debtors."[17] In such a case valuation becomes a mere abstraction with which the Court is not concerned; all that the Court does in such a case is to satisfy the judicial conscience that all parties in interest are participating; that each participant has been dealt with fairly and equitably; and that his priority, if any, has been respected.

The great constitutional question to which scant if any consideration is given in the opinions of Justices REED and DOUGLAS arises when the Commission's over-all valuation (which contrary to the expectations of Congress it invariably is) is too low to provide such participation for junior creditors or equity interests. Here the constitutional limitation comes into play to deprive the Commission's valuation of every shred of finality and to put upon the Court an imperative judicial duty to disapprove the Plan unless "satisfied"—a word of too definite import to admit of judicial surgery—that the Plan "conforms to the law of the land regarding the participation of the various classes

[17] One of the very ancient canons of statutory construction is that the preamble and declared policy of the statute are an almost infallible guide to the intent of the legislature. In the recent third Edition of Sutherland on Statutory Construction in Section 4804 we find the rule stated in the following language:

> "The key to the opening of every law, is the reason and spirit of the law * * * it is to the preamble more especially that we look for the reason, or spirit of every statute; rehearsing * * * as it ordinarily does, * * * in the best and most satisfactory manner, the object or intention of the legislature."

Turning to the caption of Chapter VIII of the Bankruptcy Act of which Section 77 forms a part it will be found to be entitled "Provision for the Relief of Debtors." But Congress was not content to have the reason and spirit of this legislation shown only by the title or preamble. Congress went further and in Section 73 it expressly repeated and declared what was said in the title or preamble to be the Congressional policy applicable to Sections 74, 75 and 77. So it was made perfectly clear that Congress intended that Section 77 should be administered and applied as a relief statute and should not be used by the Interstate Commerce Commission to destroy and wipe out the property rights of the very persons for whose benefit it was passed. It is interesting to note that this preamble and Congressional declaration of policy was called to the attention of the Supreme Court in oral argument and in at least four different Briefs filed in the *Western Pacific* case and the *Chicago, Milwaukee* case but is nowhere mentioned either in the opinion of Mr. Justice REED in the *Western Pacific* case or in the opinion of Mr. Justice DOUGLAS in the *Milwaukee* case.

of creditors and stockholders." The statute does not say that the Court must be satisfied if "the statutory standards for valuation have been followed" or that the Court must be satisfied if "it finds no legal objection to the Commission's use of its own valuation"—what it does say is that the Court must be satisfied that the Plan is fair and equitable and "conforms to the law of the land regarding the participation of the various classes of creditors and stockholders," and the law of the land is clear, definite and specific that no creditor or stockholder may be deprived of his property even in a proceeding for eminent domain by a valuation that is not *wholly* judicial.

The cases set out below are the classic authority for the fundamental constitutional proposition—one that strikes at the root of the cases under analysis—that valuation for the purpose of divesting the owner of private property is exclusively judicial.[18]

In the case last cited in an opinion written by former Chief Justice HUGHES the rule is thus epitomized:

> "The case of confiscation is illustrative, the ultimate conclusion almost invariably depending upon the decisions of questions of fact. This Court has held the owner to be entitled to 'a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts.'"

Congress knew that under a line of decisions of the Supreme Court judicial review of administrative orders had ceased to have any practical value; it knew that the Interstate Commerce Commission had learned the art of rendering innocuous the limited judicial review of its valua-

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[18] *Monongahela Navigation Co.* v. *United States*, 148 U. S. 312; *Ohio Valley Water Company* v. *Ben Avon*, 253 U. S. 287; *St. Joseph Stockyards Company* v. *United States*, 298 U. S. 38; *Baltimore & Ohio Railroad Company* v. *United States*, 298 U. S. 349; *Ohio Bell Telephone Company* v. *Public Utilities Commission*, 301 U. S. 292; *Cleveland Railway Company* v. *Backus*, 164 U. S. 439; *United States* v. *Boston and New York Canal Company*, 271 Fed. 877; *Crowell* v. *Benson*, 285 U. S. 22.

tion orders permissible under existing statutes and decisions of the Supreme Court. The process had been explained in the dissenting opinions of Justices BRANDEIS and HOLMES in the *Southwestern Telephone* case.[19] Here the Justices say of the rule of *Smyth* v. *Ames*:

> "The efforts of courts to control commissions' findings of value have largely failed. The reason lies in the character of the rule declared in *Smyth* v. *Ames*. * * * The result, inherent in the rule itself, is arbitrary action, on the part of the rate regulating body. *For the rule not only fails to furnish any applicable standard of judgment, but directs consideration of so many elements, that almost any result may be justified.*"

The Judiciary Committee of the House which, with the aid of counsel for the Federal Coordinator of Transportation, framed subsection (e) of Section 77 did not care to commit to the Interstate Commerce Commission even if it had constitutional power to do so (which it lacked) a jurisdiction to order the taking or forfeiting of private property on the basis of a valuation which was subject only to a judicial review that had been condemned as useless by Justices HOLMES and BRANDEIS. Had the Committee desired a review of that character all they needed to do was to remain silent; it already was provided by the existing law. They aimed, however, for something both useful and Constitutional and accordingly gave to the Court a mandate to review every factor that entered into a reorganization before giving it judicial approval and expressly enjoin judicial disapproval unless the Court is satisfied on every vital point. In any reorganization that excluded from participation all or any part of a class the Court was required by Clauses (1) to (3) of the first paragraph of subsection (e) to be satisfied upon every factor affecting the fairness and propriety of the reorganization which includes necessarily

[19] *Southwestern Telephone Co.* v. *Public Service Commission*, 262 U. S. at pp. 296-298.

and inevitably—Valuation, Capitalization and Public Interest. These three factors will be separately considered at a subsequent point. It may here be noted, however, that in the opinions of both Justices REED and DOUGLAS considerations of capitalization and public interest were apparently deemed to be factors having some bearing upon valuation—a concept which finds no support in the law of the land.

The possibility that the Interstate Commerce Commission might attempt to justify a confiscatory reorganization on some notion of public interest had not been overlooked by counsel for the Association of American Railroads and they filed with the Judiciary Committee of the House of Representatives which was considering recommendations of the federal Coordinator of Transportation (the Hon. Joseph B. Eastman) an objection to the language of the proposed valuation clause of subsection (e). Mr. Eastman appeared before the Judiciary Committee in advocacy of the amendatory legislation and said in opening:

> "I shall not speak at length this morning, gentlemen, because I want most of the talking to be done by my counsel, Mr. Leslie Craven, who has made an intensive study of this matter and is much better equipped to deal with the details than I am. Commissioner Mahaffie of the Interstate Commerce Commission is also here and he is exceedingly well informed in regard to railroad financial matters having dealt with them for many years, first as director of the Bureau of Finance of the Commission and afterward a Commissioner, a member of Division 4 of the Commission which deals with financial matters" (p. 13).

Mr. Craven and Mr. Mahaffie were thus accredited by Mr. Eastman to speak for him as the sponsor of the legislation. Later in the hearing Mr. Craven with Mr. Mahaffie standing by made the following answer to the suggestion of counsel for the Railroads that the Commission might attempt to coerce reorganization on the basis of depression earnings:

> "Of course that makes a perfectly outrageous picture and there is not anybody in his sane mind who would propose that these railroads be reorganized now on any such basis. Nobody proposes that. You could not get any such thing as that through a court to save your life" (p. 325).[20]

This was a representation made to the Judiciary Committee by the duly accredited representative of Mr. Eastman—a representation accepted without reservation or objection by Mr. Mahaffie—that Section 77 would not and could not be construed by the Interstate Commerce Commission as authorizing the Interstate Commerce Commission to do what it has done in these railroad reorganization cases and which the Supreme Court appears to have sanctioned.

Second, as to *Method*: This category of the valuation problem under Section 77 divides naturally into two subcategories: (a) a critical study of the past; and (b) a constructive program for the future.

In the two principal cases under analysis, the *Western Pacific* case and the *Milwaukee* case and the companion proceeding for the reorganization of the *Chicago and North Western Railway Company*, in which *certiorari* was denied, valuable equities were forfeited on the basis of a valuation by prophesy. The factor upon which the prophesy was based was depression earnings. While in all three cases the Interstate Commerce Commission made prolific references to other factors which embraced all of those set out in note 6 to the Opinion of Justices BRANDEIS and HOLMES in the *Southwestern Bell Telephone* case there was no factor that would not discredit the prophesy except depression earnings.

In the *Western Pacific* case the Commission found a capitalizable value of $85,013,472 although it was undis-

[20] Hearings before Judiciary Committee on H. R. 6249, Seventy-fourth Congress, First Session, pp. 13, 325.

puted that depreciated cost as of December 31, 1938 was in excess of $120,000,000 and the 19-A valuation was in excess of $150,000,000. An allowance of $120,000,000 would have fully protected the junior debt and capital stock. There had been periods of low and high earnings but measures to stabilize earning power at a high level were halted temporarily by the depression; part of the junior debt and the entire capital stock were forfeited on a valuation having no substantial factual support except depression earnings.[21]

In the *Milwaukee* case the Commission found a capitalizable value of $548,533,312, although the Commission filed a Report of its Bureau of Valuation showing that cost of reproduction new less depreciation plus the value of lands and rights and a stated amount of working capital amounted as of December 31, 1935 to $653,007,696. More than $100,000,000 of invested capital upon which there had been substantial earnings right up to the depression was extinguished as valueless by the Commission. There was no finding as to earning power except the negative one that "there is no evidence whatever to indicate that a recovery of the earning power of 1928-9 is reasonably probable."[22]

The case of *Chicago and North Western Railway Company* is one of the most tragic that could well be imagined and one of the most indefensible. This Railroad Company's total capitalization as of December 31, 1931, including interest accruals to that date, amounted to $612,253,200. The cost of reproduction new less depreciation plus the value of lands and working capital for the system properties was found by the Commission to be $676,793,588. $180,835,200 of the total capitalization was represented by Preferred and Common Stocks upon which dividends had been earned and paid as shown by the following table:

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[21] Brief of Debtor, Nos. 7, 8, 20, 33 and 61, October Term, 1942, pp. 26-27.
[22] Brief of Debtor, Nos. 11-19, 32, October Term, 1942, p. 19.

	Com.	Pfd.		Com.	Pfd.
1864....	..	3½%	1901....	6%	7%
1865....	..	3½%	1902....	7%	8%
1868....	5%	5%	1903....	7%	8%
1869....	9%	12%	1904....	7%	8%
1871....	10%	10%	1905....	7%	8%
1872....	3½%	7%	1906....	7%	8%
1873....	..	7%	1907....	7%	8%
1876....	..	2½%	1908....	7%	8%
1878....	3%	7%	1909....	7%	8%
1879....	4%	7%	1910....	7%	8%
1880....	6%	7%	1911....	7%	8%
1881....	6%	7%	1912....	7%	8%
1882....	6½%	7¼%	1913....	7%	8%
1883....	7%	8%	1914....	7%	8%
1884....	7%	8%	1915....	7%	8%
1885....	7%	8%	1916....	7%	8%
1886....	6%	7%	1917....	7%	8%
1887....	6%	7%	1918....	7%	8%
1888....	6%	7%	1919....	7%	8%
1889....	6%	7%	1920....	6%	7%
1890....	6%	7%	1921....	5%	7%
1891....	6%	7%	1922....	5%	7%
1892....	6%	7%	1923....	5%	7%
1893....	6%	7%	1924....	3½%	7%
1894....	6%	7%	1925....	4%	7%
1895....	7%	7%	1926....	4%	7%
1896....	5%	7%	1927....	4%	7%
1897....	5%	7%	1928....	4½%	7%
1898....	5%	7%	1929....	4½%	7%
1899....	5%	7%	1930....	4%	7%
1900....	6%	7%	1931 (to June 30)	2%	3½%[23]

The Preferred and Common Stock with the above indicated earnings record running up and in to the depression which is perhaps the most impressive record of any Railroad Company if not any corporation in the financial history

[23] Petition for *certiorari* Nos. 999-100-101; Chicago & North Western Railway Company Reorganization, 236 I. C. C. 575, 579; Poor's Manual of Railroads, 1931, p. 661.

of the United States was declared worthless by the Interstate Commerce Commission. The only factor to which any weight could have been given in such an appraisal was *depression* earnings.

There is a constitutional question whether ownership of private property may be forfeited or extinguished in a proceeding of this nature on the basis of a mere appraisal. The mortgage creditor ordinarily contracts to give to his debtor a public sale and this contract is private property of the debtor protected by due process. Similar protection is afforded to debtors generally by the local law of most states. To substitute for the protection of a public sale an appraisal resting in a large measure upon conjecture or upon what the late Joseph B. Eastman described as "an educated guess" is to raise a question of grave constitutional import. This question had not arisen and was not considered in *In re 620 Church Street Corporation*,[24] referred to by Mr. Justice REED to support his statement "the present plan may not be successfully attacked on the ground that Congress is powerless to authorize in bankruptcy the elimination of claims without value." In this case there had been judicial appraisal which the parties did not contest and as to which there was apparent agreement. It is not authority for the elimination of an equity as having no value because it is said to be without value by an administrative Board and is not authority for the rejection of a demand for a public sale by a party in interest who seeks it as a protection against the devaluation of his property. Provision for such a sale is made as a constitutional safeguard in both Section 77 and Section 77B but never has been utilized.

Assuming, however, for purpose of discussion that appraisement is a constitutional substitute for a public sale in proceedings under Section 77 the three railroad reorganizations referred to above may fairly be criticized as constitutionally unsound because (a) they permit private rights

[24] 299 U. S. 24.

to be forfeited and titles divested on the basis of an appraisement or valuation which is administrative and non-judicial whereas to be valid for such purpose and use it must be wholly judicial; and (b) they tolerate the exclusive use in such an appraisement or valuation of a factor not heretofore recognized by the law of the land: *prophesy.*

Mr. Justice DOUGLAS says in his opinion: "Certainly there is no constitutional reason why earning power may not be used as the criterion for determining value for reorganization purposes and it is our view that Congress when it passed Section 77 made earning power the primary criterion." There *is* a definite constitutional reason. The law of the land does not include earning power which is not susceptible of proof as the primary factor in a valuation to be used in confiscating private property. Expropriation on such a basis is necessarily arbitrary and in violation of due process. The use of such a factor makes possible the shocking results shown in the Report of the Judiciary Committee of the House of Representatives to which reference was heretofore made. Congress itself in subsection (e) expressly qualified the use of the earnings factor by the requirements of the law of the land.

A constructive program for the future which will avoid the tragic errors of the past as reflected by or revealed in these three railroad reorganizations may properly be asked as a justification for the criticism levelled against them. It may be admitted that criticism to be effective should be constructive and in the language of the common law should "give a better writ."

Ever since *Smyth* v. *Ames* the valuation of railroads and utilities has been a subject presenting many difficulties. There is a wealth of learning or discussion but no fixed or definite rule. The subject is complicated but not clarified by an idea featured in the opinion of Mr. Justice DOUGLAS "that value is a word of many meanings." This statement credited to Mr. Justice BRANDEIS is merely the expression

of an irrelevant truth. Whenever an appraisement or valuation is made to be used to deprive an owner of his property there is but *one* value and that is the value protected by the Fifth Amendment. The constitutionally protected value may not be undermined and written down by calling it "reorganization value" or by giving it some other name equally uninformative and inadmissible.

As the result of trial and error over the long period that has elapsed since *Smyth* v. *Ames* reproduction new less depreciation has emerged as the most dependable basic factor or criterion of value for the great majority of cases. There are cases where it is of little or no dependability but these are the exception and not the rule. The recent case of *Market Street Railway Company* v. *Railroad Commission of California*[25] is a fair illustration of the exception. Here a transit system had lost its economic value through obsolescence. The earlier case of *Atlanta, Birmingham and Coast Railroad Company* v. *United States*[26] is an equally good illustration. Here a railroad constructed primarily as a lumber road into an otherwise unproductive area ceased to have economic value when the lumber was exhausted. Reproduction values of these properties were deemed of no significance but this conclusion was based upon existing provable facts. In the absence of such provable facts reproduction costs equated to current prices represents the constitutionally protected value (subject to actual depreciation) of the debtor's property for the determination of the existence or non-existence of an equity for junior creditors and capital stock.

(2) *Capitalization.* Much is said in the opinions of Mr. Justice REED and Mr. Justice DOUGLAS on the subject of capitalization and the term is used almost as a synonym for valuation. In fact Justice REED expressly says:

> "* * * we are of the opinion that the determination by the Commission of the aggregate amount of

[25] 324 U. S. 548.
[26] 296 U. S. 33.

> securities which may be issued against the system is in substance a finding of total value for reorganization."

Earlier in the opinion the Justice had also said:

> "The development of the capitalization of the reorganized Company which is entrusted solely to the Commission under the requirement that the plan be compatible with the public interest is that relating to the total amount of issuable securities and the quality of the securities to be issued."

Little is said in Section 77 of this subject. Specific authority is given by subsection (b) to the Interstate Commerce Commission to limit the proportion of the total authorized capitalization which is to be represented by fixed interest bearing debt but no attempt was made to deal with other phases of capitalization. The fact that Congress did deal specifically with one phase of capitalization excludes under familiar rules of interpretation an implied grant of a broader power which would include that with which it dealt with specifically.

Since the passage of the Transportation Act, 1920, regulatory power over the issue of securities of interstate rail carriers has been vested in the Interstate Commerce Commission under Section 20-A of the Interstate Commerce Act. This express statutory power must be as broad as the implied power which the Supreme Court built up upon the requirement that the plan be compatible with the public interest because this identical requirement is a part of the same Section 20-A. It is therefore not clear and may not be of significance why the Supreme Court thought it necessary or expedient to spell out of the reference to the public interest in subsection (d) a grant of power to limit and control capitalization.

The opinions in both of the two cases under analysis are silent on the basic constitutional issue which Section 77 as construed by the Supreme Court so clearly presents—

the power of Congress to authorize an administrative Board by *fiat* to take or forfeit title to private property protected by due process. This is an issue that cannot be avoided. It is of course immaterial how the expropriation or forfeiture is to be achieved—whether by under-valuation or by under-capitalization. Confiscation is a thing of substance not of terminology. Protection against it is guaranteed by the Constitution through the untrammelled exercise of the judicial power vested in the Courts. Congress could not lawfully transfer that high function to an administrative Board such as the Interstate Commerce Commission and under Section 77, properly construed, it has not tried.

It is true that Mr. Justice REED has also said:

> "While the public interest phase of capitalization is not to be independently passed upon by the Court the Court does have statutory authority to review for obedience to legal standards."

This understates and unduly limits the essential judicial review of the Commission action in two aspects: it misinterprets and interprets unconstitutionally the pertinent provisions of subsection (e) of Section 77.

Subsection (e) is an unconditioned mandate from Congress to the Courts to disapprove any Plan certified to any of them by the Interstate Commerce Commission unless the Court is satisfied, among other things, that the Plan is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders and conforms to the law of the land regarding participation of various classes of creditors and stockholders. Obedience to this mandate on the part of the Court is not excused by the failure or refusal of the Interstate Commerce Commission to authorize a new capital structure that will provide recognition and participation for a class or classes whose property is being confiscated. The language of subsection (e) and of Section 77 as a whole admits of no such emasculating qualification.

Under the plain unambiguous language of subsection (e) and under the law of the land which Congress has no power to alter the injured class has an absolute right to go to the Court and demand that the Court give that class a square deal, not upon the basis of what an administrative Board has done or said but "upon its own independent judgment as to both law and facts."

(3) *Public Interest.* In a capitalistic economy it is difficult to understand why and how the confiscation of private property should or could be in the public interest. In a privately owned and operated industry such as the great system of American railways it is equally difficult to understand why and how the credit of that industry will be enhanced by the confiscation of a substantial part of the equity capital already invested therein. The fact that these questions reflect what appears to be the current philosophy of the Interstate Commerce Commission to which Congress has granted almost unlimited regulatory power over the $25,000,000,000 railway industry may be adequate cause for alarm among those whose capital is invested in railway securities but is not an aid in the analysis of the Supreme Court decisions which fail to excoriate that philosophy.

It is clear that a lower invested capital will permit a lower rate base and that a lower rate base will be a step forward toward lower cost transportation. There may be, although the point is debatable, a public interest in low cost transportation but that is not a justification for depressing the value of railway properties. The lowering of railway valuations for the purpose of securing low cost transportation is a very direct violation of the inhibition against the taking of private property for public use without just compensation and as such should be condemned by the Courts. No strength is added to the determination of the administrative Board by attributing what it does in forfeiting equities to the public interest or to an authority over capitalization and by integrating as do Justices REED

and DOUGLAS in the cases under analysis the three factors of valuation, capitalization and public interest. When the forfeiture of private property is involved the inhibitions of the Constitution apply with equal force as limitations upon the exercise by a non-judicial body of each of these separately stated powers.

Incidentally it should be noted that in inserting in subsection (e) a specific requirement that the Commission must find every approved Plan to be compatible with the public interest it was not done in any relation to capitalization. This was already provided for by Section 20-A of the Interstate Commerce Act in identical language brought into Section 77 by subsection (f).

The foregoing covers what are conceived to be those major errors in the recent reorganization decisions of the Supreme Court which might be dealt with correctively either by Congress or by the Court itself. There are others which although less fundamental seem of sufficient consequence to be noted and briefly discussed.

A very serious invasion of vested property rights of junior interests and a departure from what seems to be the apparent intent of Congress as declared in subsection (l) of Section 77 is resulting from the determination of of the Supreme Court that the Interstate Commerce Commission is given plenary power by subsection (b) to move backward and forward the effective date of a Plan of Reorganization. The Interstate Commerce Commission is exercising this power without interference by the Courts regardless of its reaction upon vested property rights, particularly those growing out of the lawful impounding by lienors of income earned *pendente lite*. In the *Milwaukee* case it appeared that a substantial if not the larger part of income earned during trusteeship and amounting to over $100,000,000 had been earned on lines between the

Missouri River and Puget Sound. The lien of the First Mortgage resting upon this extensive property had been displaced by the Plan on the theory (but without lawful evidence) that it lacked earning power and the prior right of the lienor to the income earned *pendente lite* was subordinated to claims of more favored groups of creditors. The Circuit Court of Appeals thought it "perhaps pertinent to note that Section 77(l) rather plainly provides that the date of filing of the Debtor's petition shall be the effective date of the Plan" but that Court felt bound by the decision of the Supreme Court rather than by the statute. The Supreme Court denied *certiorari.*[27] It is doubtful whether the Supreme Court understood all the implications of this determination and on further consideration may limit its effect.

Subsection (e) is quite explicit that if the Court shall disapprove a Plan there shall be a reference back to the Commission for further action and that the Commission shall proceed to a reconsideration of the proceeding under subsection (d). The last named subsection provides for the filing by a debtor or 10% of any class of creditors or stockholders of a Plan. The obvious construction of the two subsections, (e) and (d), taken together is that upon a reference back when a Plan has been disapproved the debtor or 10% of any class of creditors or stockholders shall file within the statutory period a new Plan.

In the *Milwaukee* case and perhaps others the Courts and the Interstate Commerce Commission have assumed the power to exclude from the proceeding any party whose interest has been declared to be without value. In the *Milwaukee* case the Interstate Commerce Commission denied the Debtor the right to file a new Plan or to have a further hearing or introduce additional evidence designed to establish a right to participation not accorded under

[27] *In re Chicago, Milwaukee, St. Paul and Pacific Railroad Company,* 145 Fed. Rep. 2nd 299; 324 U. S. 857.

the defunct Plan. Nevertheless the Commission itself formulated a new Plan. The Debtor undertook to show but was denied the right to show that between the date of the certification of the disapproved Plan and the reference back from the Court to the Commission there had been tremendous accretions to the trust estate which had established value for the capital stock. The Debtor's petition was an impressive one. It alleged:

> "It was in 1940 on the basis of a record closed on March 22, 1938, that the Commission limited the total capitalization of the reorganized Debtor to $548,533,321 and found that the equity of the existing stockholders was without value. Since then the Debtor's cash balance has increased by about $112,000,000, a sum greater than the entire amount of fixed interest bearing obligations authorized in the Plan then approved. If the capitalizable value of the Debtor's property was then equivalent to $548,533,321 of securities then authorized it must now by reason of this increased cash be $112,000,000 greater. Such an amount cannot be ignored in determining value for capitalization or any other purpose. These changes are accomplished facts. They do not rest on hopes for the future or prospective earnings. The cash is in the till. Efficiency has been increased. The remote possibility of earning power greater than in the previous period has become an actuality."

The Interstate Commerce Commission denied the petition on the ground that everything was foreclosed by the Supreme Court except those matters which it had expressly disapproved or questioned. The exclusion of the Debtor from further participating in the proceeding is contrary to the apparent intent of Congress and runs counter to the established rule that equity speaks as of the date of its own final decree.[28]

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[28] *Randel* v. *Brown*, 2 Howard 406, 423; *United Corporation* v. *Federal Trade Commission*, 110 Fed. (2d) 473; *Stonega Coke and Coal Co.* v. *Price*, 106 Fed. (2d) 411, 419.

It was never intended by Congress that Section 77 was to be utilized as a streamlined foreclosure—a proceeding to facilitate the forfeitures which equity has traditionally abhored. On the contrary Section 77 was conceived as a remedial statute, one that was to be permissive and not coercive under which 66⅔% of the creditors and stockholders were to have the privilege without the delay and expense of foreclosure of agreeing upon a capital readjustment of the kind described in subsection (e). This was a privilege of which they could avail or not as they saw fit. The preexisting equity procedure was left open as an alternative by subsection (i).[29] It was assumed that in most cases the bankruptcy procedure would be preferred but if a Plan was not carried through expeditiously the proceeding was to be dismissed and the parties left to their existing remedies at law and in equity. A different interpretation has diverted Section 77 from its true purpose and as a result the legislation has become thoroughly discredited. The administration of justice under its provisions is at a low ebb. In the words of Falstaff who made comedy out of tragedy: "* * * there is no equity stirring."

February 2, 1946.

[29] The recent case of *New England Coal and Coke Company* v. *Rutland Railroad Company*, 143 Fed. Rep. 2nd 179, is as yet hardly an authority to the contrary. The nature of the Court's opinion is sufficiently revealed by the following excerpt: "As several Supreme Court Justices and commentators have said, some judicial legislation is one of the unavoidable facts of life."